(1)

93-13

No. _____

Supreme Court, U.S.
FILED
JUN 29 1993
OFFICE OF THE CLERK

In The

Supreme Court of the United States

October Term, 1992

THE PRUDENTIAL INSURANCE COMPANY OF AMERICA, LEWIS EPPOLITO AND FIROZ KHAN,

Petitioners,

v.

MERLA RICE,

Respondent.

Petition For A Writ Of Certiorari To The Court Of Appeal For The State Of California (Second Appellate District, Division One)

PETITION FOR A WRIT OF CERTIORARI

ROBERT E. HINERFELD
MANATT, PHELPS & PHILLIPS
11355 West Olympic Boulevard
Los Angeles, California 90064
(310) 312-4248

Counsel of Record

Of Counsel:

DONNA FIELDS GOLDSTEIN
CLARK J. FRESHMAN
MANATT, PHELPS & PHILLIPS
11355 West Olympic Boulevard
Los Angeles, California 90064
(310) 312-4179

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

70 pp

I.

QUESTIONS PRESENTED FOR REVIEW

1. May California defeat a federally protected right to arbitrate employee termination disputes, or any other dispute governed by the Federal Arbitration Act (9 U.S.C. §§ 1 *et seq.*) (the "FAA"), by applying a State standard of appellate review which purports to defer to trial court discretion on the waiver issue even when there is no material evidence in dispute and – by uncritically affirming a trial judge's waiver finding – defeat the federally protected right to arbitrate which most federal courts of appeals would enforce after *de novo* review of the undisputed evidence in the record?

2. Does the strong federal policy of the FAA favoring arbitration and presuming against waiver of the right to arbitration absent unequivocal evidence of intent to waive *and* prejudice to the adverse party allow a California court to find defendants waived their right after defendants had demanded arbitration under the contract –

- *promptly* upon discovery of the existence of the written agreement to arbitrate,
- *before* substantial litigation reliance to plaintiff's detriment, and
- *before* any party had taken significant judicial discovery preceding plaintiff's refusal to submit to arbitration?

II.

LIST OF PARTIES AND RULE 29.1 LIST

Parties to the proceedings below were the petitioners The Prudential Insurance Company of America, Lewis Eppolito and Firoz Khan and the respondent Merla Rice. The same parties are before this Court.

Petitioner The Prudential Insurance Company of America has no parent companies; its subsidiaries or affiliates that Rule 29.1 requires it to list are in the Appendix at App. 35.

TABLE OF CONTENTS

Page

I. QUESTIONS PRESENTED FOR REVIEW i

II. LIST OF PARTIES AND RULE 29.1 LIST ii

III. OPINIONS BELOW 2

IV. JURISDICTION 2

V. STATUTE INVOLVED: FEDERAL ARBITRATION ACT, 9 U.S.C. §§ 1-2 3

VI. STATEMENT OF THE CASE 4

A. NATURE OF THE CASE 6

B. HOW THE FEDERAL QUESTIONS WERE PRESENTED 7

C. THE PROCEDURAL FACTS 8

1. Defendants Discover the Arbitration Agreement and Promptly Seek Arbitration 8

2. Only Minimal Discovery Before Arbitration Was Sought and Rejected 9

3. Trial Judge Delays Hearing and Later Refuses To Decide Merits of Defendants' Arbitration Claim: Finds Waiver Despite An Undisputed Record Refuting Waiver 10

4. The First Two Appeals and Appellate Writ Petitions on Denial of Arbitration 10

5. Pretrial Preparation While Arbitration Issue on Appeal 11

6. Trial Judge Allows A Third Amended Complaint While First Two Appeals Are Pending 12

TABLE OF CONTENTS – Continued

Page

7. Defendants Demand Arbitration of the New Claims in the Third Amended Complaint 13

8. Second Trial Judge Denies Defendants' Second Petition To Compel Arbitration of Rice's Newly Filed Claims, Based Upon a Waiver That Occurred Before Rice Had Asserted the Claims..... 14

9. Defendants File a Third Appeal From Denial of Arbitration..... 14

D. THE COURT OF APPEAL'S OPINION 14

1. The Appellate Rulings 14

2. The Prejudicial Errors By the California Court of Appeal..... 15

3. The Tension Between the Arbitration Waiver and Sanction Rulings..... 16

VII. REASONS FOR GRANTING REVIEW..... 19

A. Review Should Be Granted to Clarify the Federal Standard for State and Federal Review of a Finding of Arbitration Waiver On an Undisputed Judicial Record 19

1. The Decision in This Case and Statements of the California Supreme Court Conflict With the Law of Several Circuits Applying *De Novo* Review to Protect the Right to Arbitrate..... 19

2. If This Court Applies *De Novo* Review, It Should Remand for Entry of an Order Compelling Arbitration 24

VIII. CONCLUSION..... 28

TABLE OF AUTHORITIES

Page

CASES

Britton v. Co-Op Banking Group, 916 F.2d 1405 (9th Cir. 1990) 17, 20, 22, 24, 27

Chan v. Drexel Burnham, Lambert, Inc., 178 Cal.App.3d 632 (1986) 19

Davis Corp. v. Interior Steel Equipment Co., 669 F.Supp. 32 (D.D.C. 1987)..... 18

Fischer v. A. G. Becker Paribas, Inc., 791 F.2d 691 (9th Cir. 1986)..... 20

Fraser v. Merrill Lynch Pierce, Fenner and Smith, Inc., 817 F.2d 250 (4th Cir. 1987)..... 20

Gilmer v. Interstate Johnson Lane Corp., 111 S.Ct. 1647 (1991)..... 19

Keating v. Superior Court (Southland Corporation, r.p.i.), 31 Cal.3d 584 (1982), *rvd. on other grounds sub nom. Southland Corp. v. Keating*, 465 U.S. 1 (1984) 18, 19

Kendrick v. Bland, 931 F.2d 421 (6th Cir. 1991) 22

Mars Steel Corp. v. Continental Bank N.A., 880 F.2d 928 (7th Cir. 1989)..... 23

Pacific Inv. Co. v. Townsend, 58 Cal.App.3d 1 (1976) 18

Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc., 806 F.2d 291 (1st Cir. 1986) 20

Price v. Drexel Burnham, Lambert, Inc., 791 F.2d 1156 (5th Cir. 1986)..... 20

TABLE OF AUTHORITIES – Continued

Page

Rush v. Oppenheimer & Co., 779 F.2d 885 (2d Cir. 1985) 20

Spellman v. Securities Annuities and Insurance Services, Inc., 8 Cal.App.4th 452, *modified*, 8 Cal.App.4th 1198A (1992) 19

Tenneco Resins, Inc. v. Davy Intern., A.G., 770 F.2d 416 (5th Cir. 1985) 18

United States of America v. Jonathan Jay Pollard, 959 F.2d 1011 (D.C. Cir. 1992), *cert. denied*, 113 S. Ct. 322 (1992) 22

STATUTES

Federal Arbitration Act, 9 U.S.C. §§ 1-2 ..... 2, 3, 4

28 U.S.C. § 1257(3) 3

Cal. Gov't Code § 12940 6

U.S. Constit., Art. VI, Cl.2 16

Calif. Constit., Art. I, § 8 6

Cal. CCP § 128.5 12

MISCELLANEOUS

Wright & Miller, *Federal Practice and Procedure* §§ 2585-89 (1971 & Supp. 1990) 23

No. _____

In The

Supreme Court of the United States

October Term, 1992

THE PRUDENTIAL INSURANCE COMPANY OF MERICA, LEWIS EPPOLITO AND FIROZ KHAN,

Petitioners,

v.

MERLA RICE,

Respondent.

Petition For A Writ Of Certiorari To The Court Of Appeal For The State Of California (Second Appellate District, Division One)

PETITION FOR A WRIT OF CERTIORARI

Petitioners The Prudential Insurance Company of America, Lewis Eppolito, and Firoz Khan respectfully pray that a writ of certiorari issue to review the judgment and opinion of the court of appeal for the State of California, Second Appellate District, Division One, entered in the above-entitled proceeding on January 5, 1993.

III.

OPINIONS BELOW

The opinion of the court of appeal of the State of California for the Second Appellate District, Division One, is reprinted in the Appendix hereto, App. 1, *infra*.

The decision of the California Supreme Court denying review is reprinted in the Appendix hereto, App. 25.

The decisions of the superior court of the State of California for the County of Los Angeles denying a petition to compel arbitration are reprinted in the Appendix hereto, App. 21, and App. 23-24.

IV.

JURISDICTION

Invoking their rights under the Federal Arbitration Act, 9 U.S.C. §§ 1-2, the petitioners filed a petition for an order compelling arbitration with the superior court of the State of California for the County of Los Angeles. On May 4, 1991, the superior court denied the motion for an order compelling arbitration.

Petitioners appealed, arguing that the Federal Arbitration Act required arbitration. On January 5, 1993, the court of appeal for the State of California upheld the denial of arbitration.

Again arguing that the Federal Arbitration Act required arbitration, petitioner sought discretionary review in the Supreme Court of California. On March 31,

1993, the Supreme Court of California denied review.[1] The jurisdiction of this Court to review the judgment of the court of appeal for the State of California is invoked under 28 U.S.C. § 1257(3).

V.

STATUTE INVOLVED: FEDERAL ARBITRATION ACT, 9 U.S.C. §§ 1-2

§ 1. "Maritime transactions" and "commerce" defined; exceptions to operation of title.

> "Maritime transactions", as herein defined, means charter parties, bills of lading of water carriers, agreements relating to wharfage, supplies furnished vessels or repairs to vessels, collisions, or any other matters in foreign commerce which, if the subject of controversy, would be embraced within admiralty jurisdiction; "commerce", as herein defined, means commerce among the several States or with foreign nations, or in any Territory of the United States or in the District of Columbia, or between any such Territory and another, or between any such Territory and any State or foreign nation, or between the District of Columbia and any State or Territory or foreign nation, but nothing herein contained shall apply to contracts of employment of seamen, railroad

---

[1] While two consolidated appeals were pending from denials of the petitioners' petition to compel arbitration, the superior court allowed respondent to file a third amended complaint with new causes of action. The court of appeal did not rule on whether these additional causes of action were arbitrable and remanded to the superior court for a determination of their arbitrability in the first instance.

> employees, or any other class of workers engaged in foreign or interstate commerce.

9 U.S.C. § 1.

§ 2. Validity, irrevocability, and enforcement of agreements to arbitrate.

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2.

VI.

STATEMENT OF THE CASE

Petitioners/appellants/defendants THE PRUDENTIAL INSURANCE COMPANY OF AMERICA, LEWIS EPPOLITO AND FIROZ KHAN ["petitioners" or "defendants"] respectfully pray that a writ of certiorari issue to review the judgment and opinion of the court of appeal of the State of California, Second Appellate District, Division One, filed January 5, 1993. That decision and opinion misapply the federal law of waiver of the right to arbitrate under the Federal Arbitration Act and conflict with the decisions of several federal courts of appeal.

The court of appeal has blinked at the groundless deprivation of defendants' federally guaranteed right to arbitrate a dispute with a former employee pursuant to a

Securities Industry Form U-4, signed by the plaintiff. The court of appeal refused to decide whether any issue in the case is arbitrable by ignoring the total absence of waiver evidence after acknowledging the strong federal presumption against waiver of the right to arbitrate. Although there were no material facts in dispute, the California court of appeal followed a California Supreme Court case that stated that, even when the facts are undisputed, appellate courts review a trial court's conclusion that a defendant waived the right to arbitrate under the deferential *substantial evidence test*. California's use of the substantial evidence test conflicts with the law of most federal courts of appeals, which apply *de novo* review to determinations of waiver when the facts are undisputed.

There was no factual basis for finding a waiver under existing federal law:

- **In early January**, the trial judge would not hear defendants' motion to compel arbitration on statutory notice, thereby delaying the first hearing until mid-March. Thereafter, both sides prepared for trial because the court would not decide the threshold arbitration issue on a timely basis; as a matter of law, plaintiff's expense and inconvenience in discovery after she refused to arbitrate is not chargeable to defendants or cognizable as prejudice in the waiver calculus.

- **In March**, the court took defendants' petition to compel arbitration off calendar when the noticed petition came on for hearing, because the court, *sua sponte*, found insubstantial technical defects in defendants' papers and

required defendants to renotice the corrected petition no earlier than May, on the eve of trial.

- But **in May**, when defendants' petition came on a second time for hearing, the trial judge refused to compel arbitration by finding a waiver – based solely on the imminence of the trial.

A. NATURE OF THE CASE

Plaintiff/respondent Merla Rice ("Rice" or "plaintiff" or "respondent") sued defendants/appellants/petitioners The Prudential Insurance Company of America, Lewis Eppolito, and Firoz Khan. Rice is a former employee of Prudential; Eppolito and Khan are Prudential managers. Rice's original complaint was filed in December, 1988, but never served. Rice's first amended complaint was filed in February, 1989. It alleged sex discrimination (Calif. Constit., Art. I, § 8, and Cal. Gov't Code §§ 12940 *et seq.*), assault, battery, defamation, plus Rice's husband's claimed loss of consortium (later dismissed). In May, 1989, Rice filed a second amended complaint which added a claim for wrongful discharge in violation of public policy, based on her claim that she was discharged for seeking a smoke-free work environment.

In December 1990 – while two consolidated appeals were pending from denials of defendants' petition to compel arbitration of Rice's claims in her second amended complaint – the superior court allowed Rice to file a third amended complaint with new causes of action for wrongful termination in violation of public policy, negligent retention of managers, and sexual harassment.

The court of appeal affirmed denial of arbitration of the claims in the second amended complaint based upon waiver and remanded the questions of waiver and arbitrability of the claims in the third amended complaint.

B. HOW THE FEDERAL QUESTIONS WERE PRESENTED

As shown more extensively below, petitioners raised two federal questions in every California court in which this case was heard: (1) Does Federal law require arbitration of these disputes?; (2) Under Federal law, did petitioners waive their right to arbitrate? In their Memorandum of Points and Authorities in support of their petition to compel arbitration, the petitioners argued that, pursuant to the Federal Arbitration Act, respondent's claim was subject to arbitration, and petitioners had not waived their right to arbitrate. *See* App. 29-32. The trial court denied the petition on the ground that petitioners had waived their right to arbitrate. *See* App. 21-22. On appeal to the California court of appeal, petitioners again argued that they had the right to compel arbitration of respondent's claims under the Federal Arbitration Act, and they had not waived their right to arbitration. *See* App. 29-31. The court of appeal did not decide the issue of arbitrability, but concluded that petitioners had waived any right to arbitrate. *See* App. 8 n.8. The court of appeal recognized that federal courts of appeals apply *de novo* review to trial court determinations of waiver of the right to arbitrate under the Federal Arbitration Act, while California courts apply deferential review. *See* App. 15-16. The court of appeal purported to

find it unnecessary to resolve the conflict between the standards of review of determinations of waiver between California courts and the federal courts of appeal. *See* App. 16. Petitioners sought discretionary review in the California Supreme Court, again arguing that, under federal law, they had the right to arbitration and did not waive that right. *See* App. 32-34. In addition, petitioners argued that the California court of appeal, despite its statements to the contrary, failed to apply *de novo* review to the question of waiver, thereby refusing to follow the federal courts of appeals that apply *de novo* review to the question of waiver of the right to arbitration under the Federal Arbitration Act. *See* App. 34. The California Supreme Court denied review without comment. *See* App. 25.

C. THE PROCEDURAL FACTS

Although this case has never been tried, its procedural history is not simple. Rice filed her original complaint (never served) in December 1988, but not much happened until after defendants answered Rice's first amended complaint.

1. Defendants Discover the Arbitration Agreement and Promptly Seek Arbitration.

Defendants did not discover the arbitration agreement between Rice and the National Association of Securities Dealers (the "N.A.S.D.") and its members (Form U-4 Uniform Application for Securities Industry Registration) until late December, 1989. On January 8, 1990, defendants demanded that Rice submit the dispute to

arbitration. Little discovery had been taken by then, and the discovery cut-off date in this "fast-track" case was only nine weeks away: March 16, 1990. Rice refused to arbitrate on January 11, 1990. Defendants sought an early date from the trial judge's clerk to calendar their motion to compel arbitration, but the earliest date the clerk offered was March 14th. With the end of discovery near, on January 12, 1990, defendants moved to compel Rice's deposition. On February 2, 1990, defendants petitioned to compel Rice to arbitrate, setting the hearing on the earliest date the court had allowed: March 14, 1990 – only two days before the discovery cut-off.

2. Only Minimal Discovery Before Arbitration Was Sought and Rejected.

The only discovery taken by defendants when they demanded arbitration in early January 1990 was two sets of requests for production of documents, the deposition of a non-party witness, and service of one set of special interrogatories. Defendants had noticed Rice's deposition but they had not taken it. Rice had moved for a protective order to limit the length of her deposition.

Between February 2nd and March 14th, the superior court calendared the trial for May 7, 1990. To avoid a default in preparation for a possible trial in the superior court, defendants proceeded with pretrial discovery while awaiting hearing and decision of their petition to compel arbitration. Rice's refusal to arbitrate and the court's inability to hear the arbitration issue left defendants with no alternative.

3. Trial Judge Delays Hearing and Later Refuses To Decide Merits of Defendants' Arbitration Claim: Finds Waiver Despite An Undisputed Record Refuting Waiver.

On March 14, 1990, the first hearing date on defendants' petition to compel arbitration, the court, *sua sponte,* placed defendants' petition off calendar because of technical defects in the moving papers which Rice had not raised.[2] Counsel immediately reserved the next available hearing date and cured the technical defects the next day. But the next available hearing date was May 4, only one court day before the scheduled trial date. On March 15, 1990, defendants sought an *ex parte* order specially to reset their petition for the earliest possible hearing date. The trial judge denied the motion.

4. The First Two Appeals and Appellate Writ Petitions on Denial of Arbitration.

On March 22, 1990, defendants noticed appeals from the superior court's orders of March 14 and 15, treating the court's two orders as *de facto* denials of defendants' first petition to compel arbitration.

---

[2] The technical defects were: (i) defendants' counsel, *who was present in court at the aborted hearing,* had failed to sign his declaration, (ii) a supplemental declaration was filed late as a *supporting* declaration rather than as a *reply* declaration, (iii) the absence of a copy of the Form U-4 as an exhibit to a declaration (although the same Form U-4 was annexed to the verified petition to compel arbitration which was before the court), and (iv) *side*-tabbing of the compendium of authorities rather than *bottom*-tabbing.

Defendants vigorously pressed their effort to obtain arbitration and sought stays of the trial court proceedings pending final adjudication of the arbitration issue. Twice they sought relief in the Court of Appeal of the State of California, Second Appellate District, by petitions for writ of mandate (No. B048947, filed March 23, 1990, and No. B049037, filed March 30, 1990) to determine whether the two superior court orders were appealable. The court of appeal summarily denied both writ petitions.

5. Pretrial Preparation While Arbitration Issue on Appeal.

The failure of both the trial and appellate courts to resolve the arbitration issue left defendants with no alternative but to continue trial preparation. The trial date in early May was imminent, but the trial judge would not hear the threshold arbitration issue until discovery was complete and the trial was about to begin.

On April 2, 1990, the trial judge denied defendants' motion for summary adjudication. On April 19, 1990, defendants renoticed for May 4th their original petition to compel arbitration of the claims in Rice's second amended complaint (correcting the technical matters noted by the trial judge on March 14th). On May 4th, the court denied defendants' renewed petition as untimely on the ground that it came on for hearing on the eve of trial.[3] The same day, defendants noticed an appeal from

---

[3] The trial judge not only denied defendants' petition to arbitrate, he also imposed $3,000 sanctions upon defendants and their counsel on the ground that filing that petition for

the orders of May 4, 1990. Three days later, the superior court stayed the trial pending determination of defendants' appeal from denial of the petition to compel arbitration of the claims in Rice's second amended complaint.

On or about May 7, 1990, Rice moved to dismiss defendants' appeals from the orders of March 14 and 15, 1990 on the ground that those orders were not appealable. On June 1, 1990, the court of appeal denied that motion. On July 9, 1990, by stipulation, the two appeals were consolidated.

6. Trial Judge Allows A Third Amended Complaint While First Two Appeals Are Pending.

Rice moved the superior court for leave to file a third amended complaint on December 4, 1990, while the two consolidated appeals were pending. The court granted the motion over defendants' opposition. The opposition was based upon the trial court's lack of jurisdiction while the first two appeals were pending in the court of appeal. On December 19, 1990, the trial court granted Rice's motion, directed defendants to respond to the new pleading, and ordered the parties to proceed with discovery on the new claims while the first and second appeals were pending. The third amended complaint added a third cause of action for wrongful termination in violation of public policy for protesting the insurance sales practice of "leveraging," a seventh cause of action for negligent retention of managers who engaged in "leveraging" and

---

hearing on the eve of trial constituted bad faith under Calif. Code of Civil Procedure § 128.5.

sexual harassment, plus an eighth cause of action for intentional infliction of emotional distress based upon such practices. These were all newly raised claims.

Defendants answered the third amended complaint on January 8, 1991. Three days later, Rice requested dismissal of her eighth cause of action (for intentional infliction of emotional distress) with prejudice.

On January 10, 1991, defendants petitioned the court of appeal for a writ of mandate or supersedeas, seeking to vacate the superior court's order allowing filing of the third amended complaint, based upon the trial court's lack of jurisdiction to proceed in a case that was on appeal. On January 17, 1991, the court of appeal issued a stay until January 30 for Rice to file an opposition. On February 7, 1991, the court of appeal denied defendants' writ petition.

7. Defendants Demand Arbitration of the New Claims in the Third Amended Complaint.

On February 27, 1991, defendants made written demand on Rice to arbitrate the new claims in her third amended complaint. On March 20, 1991, Rice indicated she was unwilling to arbitrate and requested legal authority for defendants' demand for arbitration of her new causes of action. On April 30, 1991, defendants informed Rice that they understood that Rice's position was that she was refusing to arbitrate her newest causes of action; therefore, defendants would petition to compel Rice to arbitrate those new claims. On July 10, 1991, defendants filed that petition.

8. Second Trial Judge Denies Defendants' Second Petition To Compel Arbitration of Rice's Newly Filed Claims, Based Upon a Waiver That Occurred Before Rice Had Asserted the Claims.

On July 26, 1991, a newly assigned trial judge denied defendants' third petition to compel arbitration, basing his denial on the theory that defendants had waived their right to arbitration, as determined earlier by the first trial judge in respect to the second amended complaint, and that waiver applied even to causes of action that Rice did not assert until after the first waiver ruling. The new judge also awarded $2,500 in sanctions against defendants' counsel for having sought arbitration after defending against Rice's claim pending a ruling on their petition.

9. Defendants File a Third Appeal From Denial of Arbitration.

On August 6, 1991, defendants filed their third appeal in this case, seeking review of the denial of the third petition to arbitrate and the associated sanctions order against counsel. The parties thereafter stipulated to consolidate the third appeal with the first two appeals.

D. THE COURT OF APPEAL'S OPINION.

1. The Appellate Rulings.

On January 5, 1993, the California court of appeal:

- dismissed defendants' first appeal (B049037),
- affirmed the denial of defendants' petitions to arbitrate the claims in the second amended

complaint based on waiver of arbitration, but reversed the order awarding sanctions against defendants and their counsel (B050301), and

- reversed the order denying defendants' petition to arbitrate the third amended complaint (B060473), reversed the order awarding sanctions against defendants' counsel, and remanded the issues in the third appeal for reconsideration in the light of its opinion.

2. The Prejudicial Errors By the California Court of Appeal.

The decision below is basically flawed by internal inconsistency about the applicable rules of decision on waiver (federal *vs.* California), aggravated by a cramped application of the controlling federal law. Federal law presumes against a waiver of an arbitration claim where the purported waiver is not unequivocal and the adverse party has not suffered prejudice from the defendant's failure to request arbitration at the outset of the lawsuit.

The court of appeal blurred the issue on choice of law on waiver, *see* App. 14-15, and whether federal or California standards governed appellate review of a trial court's finding of a waiver of the federally protected right to arbitrate. *See* App. 15-16. The California court ignored the trial judge's prejudicial disregard of the applicable federal law – which presumes against waiver – and deferred to the lower court's exercise of discretion about undisputed facts that would not support waiver either under California or federal standards. The undisputed material

facts disclosed no waiver. There is no evidence of defendants' intent to utilize the judicial process once they had discovered the arbitration agreement and until the plaintiff had refused defendants' demand to arbitrate and the fast track judge's impractical calendar would not allow the arbitration issue to be addressed in a timely manner.

Both the trial judge and the reviewing court should have reached the merits of defendants' demand for arbitration under the Federal Arbitration Act rather than resolving the case on the basis of waiver of the federal right. A federal appellate court would have applied *de novo* review to vindicate the federally protected right to arbitrate these employment claims. A California appellate court should have treated the arbitration waiver issue as a question of law. The trial court's resolution of the issue was not entitled to deference because there were no material facts in dispute. The court of appeal's misuse of a purportedly more restricted standard of review rationalized an erroneous decision both under federal and California law and also threatens a violation of the Supremacy Clause (U.S. Constit., Art. VI, Cl.2). After recognizing the conflict of review standards, *see* App. 15-16, the court of appeal tried to ignore its effect by concluding that waiver existed here under either standard of review, although no facts were found in the judicial record to satisfy the federal rules on waiver of arbitration. *See* App. 15-16.

3. The Tension Between The Arbitration Waiver and Sanction Rulings.

These errors become glaringly apparent upon comparison of the court of appeal's explanation for finding waiver, *see* App. 16, with its rationale for reversing both

sanction orders. *See* App. 17-18. In order to reverse the sanctions orders, the appellate court had to recognize and give effect to controlling principles of federal arbitration law which required reversal of the orders denying the petitions to compel arbitration. The fact that significant discovery was taken only *after* plaintiff had refused defendants' demand for arbitration is not merely a proper basis to reverse the sanctions award. It is also the reason why it was prejudicial error for the trial judge to refuse to consider the merits of defendants' demands to arbitrate the issues presented by the various editions of Rice's complaint and prejudicial error for the court of appeal to affirm those rulings except as to the third amended complaint.[4]

The court of appeal avoided deciding whether any issue in any edition of Rice's pleadings was arbitrable. Nevertheless, it is apparent from what the appellate court

---

[4] In the sanctions section of its opinion, the court of appeal reveals its misunderstanding of the federal law on waiver – implying that State judges may have reasonable differences of opinion whether the federal right was waived, even if federal judges could not: "It is thus apparent that, while the trial court's finding of waiver was proper, such finding was not necessarily required under the circumstances of this case. Accordingly, the determination that Prudential's conduct in bringing the second petition was frivolous and in bad faith for the sole purpose of harassing Rice is without foundation and must be reversed." *See* App. 18. *Compare Britton v. Co-Op Banking Group*, 916 F.2d 1405, 1409 (9th Cir. 1990) (reversing a finding of waiver of arbitration under the FAA, as erroneous *as a matter of law*, after *de novo* review).

said on the sanctions issue, *see* App. 18,[5] that all of Rice's claims were subject to arbitration if the federal arbitration law is applied to the uncontradicted circumstances in the record.[6]

---

[5] In reversing the sanctions award, the court of appeal cited three cases on the merits of the waiver issue from defendants' reply brief standing for the proposition – in the court of appeal's own words – that "the defendant was considered to be merely protecting its own interests in continuing to participate in litigation after a request for arbitration had been refused by the plaintiff. (*See Tenneco Resins, Inc. v. Davy Intern., A.G.* (5th Cir. 1985) 770 F.2d 416, 421; *Davis Corp. v. Interior Steel Equipment Co.* (D.D.C. 1987) 669 F.Supp. 32, 33-34; *Pacific Inv. Co. v. Townsend* (1976) 58 Cal.App.3d 1, 12.)"

[6] It is not clear why the court of appeal remanded to the superior court the question of arbitrability of the claims raised for the first time in the third amended complaint. Based on the court of appeal's own description of what should have been decided by the trial judge, the issues seem to be undisputed matters solely in the written record which are equally within the competence of an appellate court to decide *de novo*. *See* App. 16. Indeed, respondent's and petitioners' cross-petitions for review in the California Supreme Court each criticized the court of appeal's opinion because it failed to decide that legal issue.

For example, in a case cited by the court of appeal, *inter alia*, on the waiver issue, *see* App. 15, *Keating v. Superior Court (Southland Corporation, r.p.i.)*, 31 Cal.3d 584, 606 (1982), *rvd. on other grounds sub nom. Southland Corp. v. Keating*, 465 U.S. 1 (1984), the California Supreme Court decided in the first instance, as an alternate ground for finding no waiver of the federal right to arbitrate, that the defendants had not waived arbitration as to new claims which the plaintiffs had introduced in amended pleadings. The court of appeal should have followed that principle in the cognate circumstances of this case.

On the merits of arbitrability, the United States Supreme Court recently has resolved any question whether a securities registration form arbitration clause is enforceable under the

VII.

REASONS FOR GRANTING REVIEW

A. Review Should Be Granted to Clarify the Federal Standard for State and Federal Review of a Finding of Arbitration Waiver On an Undisputed Judicial Record.

1. The Decision in This Case and Statements of the California Supreme Court Conflict With the Law of Several Circuits Applying *De Novo* Review to Protect the Right to Arbitrate.

The main reason the California court of appeal failed to enforce the FAA's presumption against arbitration waiver is the court's confusion about the standard of appellate review of this federal right in the context of an undisputed court record. The court of appeal acknowledged the facial conflict between the federal and California standards of review on such issues, noting that the California Supreme Court has used the linguistic formulation of the *substantial evidence rule* in deciding arbitration waiver cases whereas the federal appellate courts have adopted the *de novo* review standard. *See* App. 15, citing *Keating, supra*, 31 Cal.3d at 605.

The California Supreme Court's application of the deferential substantial evidence rule is in direct conflict with those federal courts of appeals that apply *de novo*

FAA. It is. *See Gilmer v. Interstate Johnson Lane Corp.*, 111 S.Ct. 1647 (1991). *See also Chan v. Drexel Burnham, Lambert, Inc.*, 178 Cal.App.3d 632, 638 (1986). Nor does it matter if the registration form is signed by a securities salesperson who also sells insurance policies. *See Spellman v. Securities Annuities and Insurance Services, Inc.* 8 Cal.App.4th 452, modified, 8 Cal.App.4th 1198A (1992).

review in order to protect the federally guaranteed right to arbitration. *See Britton v. Co-Op Banking Group*, 916 F.2d 1405, 1409 (9th Cir. 1990) (reversing a finding of waiver of arbitration under the FAA, as erroneous *as a matter of law*, after *de novo* review); *Fraser v. Merrill Lynch Pierce, Fenner and Smith, Inc.*, 817 F.2d 250, 252 (4th Cir. 1987) ("plenary review comports with the standard applied by other courts to the question of waiver of arbitration where the underlying facts were not in dispute"); *Page v. Moseley, Hallgarten, Estabrook & Weeden, Inc.*, 806 F.2d 291, 294 n.2 (1st Cir. 1986); *Price v. Drexel Burnham Lambert, Inc.*, 791 F.2d 1156, 1159 (5th Cir. 1986); *Fischer v. A. G. Becker Paribas, Inc.*, 791 F.2d 691, 693 (9th Cir. 1986); *Rush v. Oppenheimer & Co.*, 779 F.2d 885, 887 (2d Cir. 1985). But the California court of appeal in this case avoided close analysis of the uncontested facts below by purporting to find it unnecessary to resolve this conflict:

> In the context of this case, we need not decide whether the state or federal standard of waiver should be applied or whether the trial court's determination is subject to *de novo* review or the substantial evidence test. As to the former, we perceive no meaningful difference in the waiver analysis undertaken by state and federal courts, and as to the latter, we find no reason to reverse the order of the trial court under any standard of review.

App. 16.

In fact, as shown above in the analysis of the California court of appeal's reversal of the sanctions award, the court could not have applied the *de novo* review applied by the federal courts of appeals. Failure to apply *de novo*

review undermines the federally protected right to arbitrate; it largely commits the right to arbitrate to a single judge. Protection of the right to arbitrate requires access to *de novo* appellate review.

Therefore, the main mischief done in the opinion below was to obscure the fact that when there are no material facts in dispute, questions of waiver of a right to arbitration under the Federal Arbitration Act are questions of law which must be decided on appeal without any deference to the trial court's views. Waiver of arbitration questions involve legal analysis and application of legal principles to facts in a court record – what happened in the record of a judicial proceeding – not what occurred outside the boundaries of the lawsuit. The procedural history of lawsuits generally is not a matter in dispute.

Deference to a fact finder below is desirable where a trial court must decide live witness credibility. The court here did not have to evaluate the credibility of witnesses about material facts on which live witnesses or documents may disagree. The waiver analysis concerned: (i) *when* defendants requested arbitration, (ii) *what* significant events, if any, had occurred in the lawsuit before defendants sought arbitration, (iii) *whether* the totality of those facts indicated an unequivocal intent of defendants to surrender their federal arbitration right and participate in resolving the merits of the litigation in the courts, and, last, but not least, (iv) *whether* plaintiff had suffered any prejudice from defendants' failure to request arbitration at the outset of the lawsuit and *before* plaintiff opted to refuse to arbitrate. The single trial judge had no institutional advantage over the three appellate justices in

determining whether this record overcame the strong federal presumption against arbitration waiver. *See, e.g., Britton v. Co-Op Banking Group,* 916 F.2d 1405, 1412-13 (9th Cir. 1990) (waiver finding reversed, notwithstanding defendant did not demand arbitration until one year after he was sued and did not move to compel arbitration until 18 months after the lawsuit began).

This Court may leave for another day the question whether there will be cases in which a trial court may have a special advantage over a reviewing panel in deciding if certain disputed conduct of a party demanding arbitration involves resolution of conflicting testimonial evidence in order to overcome the federal anti-waiver presumption. This case, like most arbitration waiver cases, does not have such an appellate record. The material events are all in the court record, and they do not involve live testimony that is subject to credibility evaluation. There is a danger of abdication of the appellate court's law-declaring function if the court delegates too broadly the function of *characterizing* undisputed conduct.[7] That is what the California court of appeal did

---

[7] *See,* dissenting opinion of Circuit Judge Williams in *United States of America v. Jonathan Jay Pollard,* 959 F.2d 1011, 1033 (D.C. Cir. 1992), *cert. denied,* 113 S. Ct. 322 (1992).

> We review a trial court's findings of pure fact (what happened) under the clearly erroneous standard. And we defer to district court findings even on fact-intensive issues of characterization, such as whether particular conduct, about which there is no factual dispute, violates a norm that courts have defined with as much clarity as they can expect to achieve. Thus in *Kendrick v. Bland,* 931 F.2d 421 (6th Cir. 1991), the court applied the clearly erroneous standard to findings as

below. The appellate court here refused to apply its critical faculties to the same uncontradicted facts which the trial judge had before him, to see that none of those facts justify departure from the "overriding federal policy favoring arbitration."

The court of appeal shirked its reviewing function when it declined to reweigh the uncontested procedural evidence on the waiver of right to arbitration. Appellate

---

to whether specific conduct by prison officials – *e.g.*, cancellation of club activities – constituted "institution-wide" violations of a consent decree.
The appellate deference in this last category is somewhat anomalous, as the characterization is in a way part of the law-finding process; it answers a normative question (whether the conduct was acceptable or not), and thus in some measure refines the norm. But where the characterization process is extremely fact-intensive, the appellate decision may not yield a useful contribution to the formulation of legal rules, so that appellate judges' duplication of the trial court's effort would consume judicial resources for very little return. *See Mars Steel Corp. v. Continental Bank N.A.*, 880 F.2d 928, 933-36 (7th Cir. 1989) (en banc) (Easterbrook, J.). By the same token, however, review for clear error cannot fade off into complete deference, else the appellate court's law-finding (or law-forming) function would be disconnected from the real world. Moreover, presumably because of a recognition of the law-forming aspect of fact-intensive characterizations, the decisions on deference appear replete with contradictions and inconsistency. *See* Wright & Miller, *Federal Practice and Procedure* §§ 2585-89 (1971 & Supp. 1990). Perhaps one can do no better than to say that there is deference, but that the special character of the practice informs its nature.

courts should not undermine the strong presumption against waiver of the federal right to arbitrate by reliance on the substantial evidence rule when the material facts on the waiver issue are not in dispute and there is no occasion to defer to the special fact-finding powers of a trial court.

This Court should grant certiorari to inform the California courts, and state courts generally, that they must implement the federal legislative policy to foster arbitration where the trial court record provides no occasion for trial court discretion in resolving claims that the right to arbitration has been waived.

2. If This Court Applies *De Novo* Review, It Should Remand for Entry of an Order Compelling Arbitration.

If this Court applies *de novo* review, then it should remand for an entry of an order compelling arbitration. It is clear under the cases, that any discovery or other pretrial activity in the lawsuit after the plaintiff refused to arbitrate is irrelevant to a proper decision of waiver of rights under the FAA. In *Britton*, for example, the Ninth Circuit rejected plaintiffs' claim of prejudice from defendant Liebling's 18-month delay in moving to compel arbitration:

> [I]t was appellees who refused to arbitrate, and the costs they incurred in pursuing litigation should not count against Liebling's effort to avoid litigation. Just as Liebling must bear the risk that his appeal would not be successful, appellees, if they choose to resist Liebling's

> effort to arbitrate the dispute, must bear the risk that it will be successful.

Id. at 1413.

The imminence of the scheduled trial when defendants' motion to compel arbitration came on for its second hearing, was not a proper reason to deny arbitration under the FAA. Defendants should not be prejudiced in the waiver analysis by what happened in the lawsuit after they demanded arbitration in early January, 1990, and the plaintiff refused to arbitrate. Defendants had no choice then but to prepare for trial. That was four months before the trial and before the significant pretrial discovery and motion practice occurred. The trial court would not calendar the hearing earlier than six weeks after defendants asked the clerk for a hearing date. Then the judge took the petition off calendar for insubstantial technical defects in the motion papers of which the plaintiff had not complained. Although the defects were remedied immediately, the trial judge still would not hear the arbitration issue until two months later, on the eve of the trial.

Assuming, *arguendo*, that there were sound reasons of calendar management which prevented the court from hearing the petition to compel arbitration in January or February, nevertheless, the doctrine of *waiver* of an FAA-based right does not permit a finding of waiver in such circumstances.

> A party seeking to prove waiver of a right to arbitrate must demonstrate (1) knowledge of an existing right to compel arbitration; (2) acts inconsistent with that right; and (3) prejudice to the party opposing arbitration resulting from

> such inconsistent acts. The party arguing waiver of arbitration bears a heavy burden of proof.

Id. at 1412.

- The record here contains no evidence that defendants knew they had a signed Form U-4 until late December, 1990. Defendants tried to invoke arbitration promptly upon their discovery of the signed arbitration agreement.

- Nor is there any evidence of "acts inconsistent with" the arbitration right once defendants knew they had the right. There was no significant use of court procedures before defendants demanded arbitration. Defendants' first step after discovery of the N.A.S.D. arbitration agreement was to make written demand on Rice to arbitrate. Rice immediately refused to arbitrate. Thereafter, as the Ninth Circuit decision in *Britton* suggests, defendants are not responsible for the ensuing litigation activity, because plaintiff gambled knowingly on the threshold question of arbitrability and defendants were not seeking unfair advantage from the judicial process by preparing the case for trial before the court would decide whether there should be a trial or an arbitration.

- The court of appeal affirmed the waiver decision although that "finding" could not be reconciled with the federal cases:

> [T]he reality of this case is that a judicial determination of the validity of that demand (with its attendant issue of whether Form U-4 covered Rice's claims) did not take place until the very eve of trial, after completion of a tremendous amount of discovery (which required judicial resolution of several contested issues) and a " 'judicial litigation' " [citation omitted] in

> Rice's favor of Prudential's motion for summary adjudication of issues. By the time of the hearing Rice, ***through no fault of her own***, had been required to "bear the costs of trial preparation, which arbitration is designed to avoid" [citation omitted], and had been forced to "disclose [her] defenses and strategies." [Emphasis added.]

App. 16.

Of course, this analysis is flatly at odds with the Ninth Circuit's reading of the FAA waiver doctrine as evidenced by *Britton, supra* – a case cited on another issue in the court of appeal opinion below. *See* App. 15. If defendants had a right to arbitrate these disputes and the plaintiff erred in refusing to submit to arbitration, then all of the expense and activity in this case after early January, 1990 was the plaintiff's *fault*. None of it would have been necessary if Rice had kept her original bargain to arbitrate rather than to litigate. To the extent that some of the litigation costs and delay were the result of the inefficient way the superior court handled its calendar in this case, that was no more defendants' fault than the plaintiff's.

In summary, the opinion of the California court of appeal misapplies the controlling federal standards on waiver of arbitration under the FAA. If the federal law is applied, then defendants did not waive their right to arbitrate.

VIII.

CONCLUSION

For the foregoing reasons, petitioners request this Court to grant certiorari to:

- Clarify the standards of state appellate review of claims of waiver of the federally protected right to arbitrate claims under an N.A.S.D. registration agreement

  and

- Vindicate the federal right to arbitrate where an uncontradicted record discloses no unequivocal evidence of waiver and no material prejudice to the plaintiff.

DATED: June 28, 1993.

Respectfully submitted,

ROBERT E. HINERFELD
MANATT, PHELPS & PHILLIPS
11355 West Olympic Boulevard
Los Angeles, California 90064
(310) 312-4248

Counsel of Record

Of Counsel:

DONNA FIELDS GOLDSTEIN
CLARK J. FRESHMAN
MANATT, PHELPS & PHILLIPS
11355 West Olympic Boulevard
Los Angeles, California 90064
(310) 312-4179

NOT TO BE PUBLISHED
IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION ONE

MERLA RICE, Plaintiff and Respondent, v. PRUDENTIAL INSURANCE COMPANY OF AMERICA et al., Defendants and Appellants.	)	B049037 B050301 B060473 (Super.Ct.No. C708681) (Filed Jan. 5, 1993)

APPEALS from orders of the Superior Court of Los Angeles County, David A. Workman and Carol J. Fieldhouse, Judges. B049037 dismissed; B050301 affirmed in part and reversed in part; B060473 reverses with directions.

Manatt, Phelps, Phillips & Kantor and Donna Fields Goldstein for Defendants and Appellants.

John Elson for Plaintiff and Respondent.

Defendants The Prudential Insurance Company of America, Lewis Eppolito and Firoz Khan (sometimes collectively "Prudential") prosecute three separate appeals from orders of the superior court which denied contractual arbitration of an action brought by plaintiff Merla Rice and awarded sanctions to Rice pursuant to Code of Civil Procedure section 128.5. We dismiss B049037. In

B050301, we affirm the order denying arbitration and reverse the order awarding sanctions. In B060473, we reverse the orders denying arbitration and awarding sanctions.

BACKGROUND

Rice's original complaint was filed in Los Angeles Superior Court on December 16, 1988, and assigned pursuant to the Trial Court Delay Reduction Act. (See Gov. Code § 68600 et seq.) A first amended complaint was filed on February 10, 1989, alleging causes of action in sex discrimination, assault, battery, and defamation.[1] The gravamen of the complaint was that Rice, who was employed by Prudential as an insurance agent, was sexually harassed by her superiors and, in retaliation for her rejection to sexual advances, was moved to the "smoking section" of the office despite her request to work in a smoke-free environment.

Prudential was served on March 17, 1989. Thereafter, pursuant to a stipulation of the parties, Rice filed a second amended complaint on May 14, 1989, which added a cause of action for wrongful discharge in violation of public policy. Prudential filed its answer on May 26, 1989.

On January 5, 1990, Rice's motion for a protective order to limit the length of her deposition was denied. During that proceeding, on Rice's motion, the discovery cut-off date was extended to March 16, 1990.

---

[1] A loss of consortium cause of action was also stated by Rice's husband. It was subsequently dismissed, and he is not a party to these appeals.

On February 2, 1990, Prudential filed a petition to compel arbitration and stay further court action, set for hearing on March 14, 1990. The petition relied on Rice's having signed, as part of her employment with Prudential, a Uniform Application for Securities Industry Registration or Transfer Form U-4 ("Form U-4"), which contained an arbitration clause. The petition included counsel's declaration that he had discovered the existence of Form U-4 in "late December 1989;" had sent a letter to Rice demanding arbitration on January 8, 1990; and was advised by telephone on the following January 11 that Rice would not agree to arbitration. In the petition, Prudential asserted that Rice's causes of action were covered by Form U-4 and that, based on the amount of discovery which had been completed when the demand for arbitration was rejected, Rice had not been prejudiced by any delay in seeking arbitration. The petition acknowledged that Prudential was continuing to engage in discovery, but argued it was required to do so "based upon [Rice's] refusal to arbitrate, her insistence upon litigating her claims in court, and the need for [Prudential] to mount a defense in this action pending the Court's ruling on the petition."

On February 14, 1990, an order was filed setting, among other things, a trial date of May 7, 1990.

On March 14, 1990, Prudential's petition for arbitration was ordered off calendar for "procedural defect" based on violation of the Law & Discovery Policy Manual sections 116 (Requirements for Attorney-Generated Documents Presented for Filing in Civil Cases), 138 (Incomplete Motions), 140 (Declarations, Local Requirements, CCP § 2015.5) and 145 (Notice of Hearing and Filing of

Papers, "Time for filing"), and Code of Civil Procedure[2] sections 1005 (Time for giving notice of motion or filing opposing papers), and 2015.5 (Use of unsworn statements). In denying Prudential's request to put the petition back on calendar in a day or two when the procedural defects had been cured, the court commented that the petition was "one of the sloppiest jobs [it had] seen in a long time."[3]

On March 15, 1990, Prudential filed an ex parte application for an order shortening time within which to hear its "cured" petition to compel arbitration. The application noted that May 4, 1990, was the earliest possible hearing on a renoticed petition, and that a motion for summary adjudication of issues had been calendared on April 2 and trial remained set for May 7, 1990. Prudential's ex parte application was denied the day it was filed.

On March 22, 1990, Prudential filed a notice of appeal from the orders of March 14 and 15, 1990. (B049037, hereafter "the first appeal.") Prudential also sought extraordinary relief from this court pursuant to petitions for writ of mandate and supersedeas, requesting that the orders of March 14 and 15 be deemed a denial of its petition to compel arbitration, and further requesting a stay of proceedings in the trial court pending appellate review of that denial. Prudential's petitions were denied on March 28 and 30, 1990, respectively.

---

[2] Unless otherwise specified, all further statutory references are to the Code of Civil Procedure.

[3] In essence, the petition contained an unsigned and an untimely declaration, and exhibits had been omitted or improperly presented.

On April 19, 1990, Prudential filed a petition to compel arbitration (hereafter "the second petition"), set for hearing the following May 4. The second petition continued to cite Form U-4 as the basis for arbitration. Although substantial discovery had been completed, Prudential argued that the petition was still timely because arbitration had been demanded earlier in the proceedings, and it had no choice but to continue to prepare for trial on May 7, 1990. Rice's opposition to the second petition included a request for sanctions.

On Friday, May 4, 1990, Prudential's second petition came on for hearing. By that time, with trial set for the following Monday, both parties had engaged in extensive discovery, including numerous depositions (Rice's deposition had lasted 10 full days) and motions by Prudential seeking to inquire into Rice's sexual conduct and to compel Rice to submit to a psychological examination and to produce documents. Prudential had also filed a motion for summary adjudication of seven enumerated issues, which had been denied in full on April 2, 1990.

The second petition was denied. The trial court did not reach the merits of whether Rice's claims were covered by Form U-4, but rather found that Prudential had waived any right to arbitration by failing to bring the matter on for hearing until "the very eve of trial long after the complaint was filed, particularly after the court's determination of [Prudential's] motion for summary adjudication of issues." The court noted that a February 14, 1990 status conference date had been set the previous October, and "specifically . . . fault[ed]" Prudential for failing to seek an order shortening time on a petition to compel arbitration the previous January,

immediately after Rice had refused its demand.[4] The court further ordered Prudential and its counsel to pay $3,000 sanctions pursuant to section 128.5.

Also on May 4, 1990, Prudential filed a notice of appeal from the orders entered that day. (B050301, hereafter "the second appeal.") As a consequence of filing the second appeal, on May 7, 1990, the trial court ordered further proceedings stayed pursuant to sections 1294, subdivision (a) [an aggrieved party may appeal from an order denying a petition to compel arbitration], and 916, subdivision (a) [the perfecting of an appeal stays proceedings in the trial court]. (See also *Prudential-Bache Securities, Inc.* v. *Superior Court* (1988) 201 Cal.App.3d 924, 925.)[5]

On December 4, 1990, Rice filed a motion requesting leave to file a "fifth amended complaint,"[6] which sought to add a cause of action for wrongful termination in

---

[4] Indeed, on January 12, 1990, the day after Rice refused arbitration, Prudential filed an ex parte application for an order shortening time within which to serve a discovery motion.

[5] Prudential did not inform the court of its May 4 filing of a notice of appeal until after the matter was called for trial on May 7. At that time, Prudential (as well as Rice) announced "ready" for trial, but shortly thereafter informed the court of the appeal. The court chastised Prudential for causing it to 'spen[d] a lot of time over the weekend preparing for this trial,' but ordered the proceedings stayed based on the pendency of the appeal.

[6] Rice had previously requested leave to file third and fourth amended complaints. On February 8, 1990, the court denied both requests, finding that the request for leave to file the fourth amended complaint had mooted the request as to the third amended complaint, and that Rice's request to amend her pleading had been filed too late in the proceedings.

violation of public policy based upon her refusal to engage in a sales practice known as "leveraging" and to forge checks, and a cause of action for negligence based on Prudential's allowing its employees to sexually harass her and to engage in leveraging.[7]

On December 19, 1990, Rice's motion was granted, with the proviso that the pleading would be denominated the "third amended complaint." Prudential was ordered to respond within 20 days of service.

Prudential filed its answer to the third amended complaint on January 8, 1991. Thereafter, Prudential petitioned this court for extraordinary relief, arguing that the filing of the third amended complaint was barred by the pendency of the first and second appeals. Prudential's petition was denied on February 7, 1991.

On July 10, 1991, Prudential filed another petition to compel arbitration (hereafter "the third petition"), addressed to the new claims contained in the third amended complaint. The third petition contained exhibits reflecting that Prudential had demanded arbitration of the new claims on February 27, 1991, and that, following disagreement about whether the claims were subject to arbitration, Rice refused to arbitrate on April 30, 1991. Rice's opposition again requested sanctions.

On July 30, 1991, the third petition came on for hearing before a different judge than the one who had presided at the hearings on the first and second petitions.

---

[7] A cause of action for intentional infliction of emotional distress was also alleged, but it was subsequently dismissed and is not relevant to this appeal.

The third petition was denied, the court commenting that "[o]nce your right to arbitrate is waived, it's waived for the whole case." The court also ordered $2,500 in sanctions payable by Prudential's cousnel to Rice's counsel.

On August 6, 1991, Prudential filed a notice of appeal from the denial of the third petition. (B060473, hereafter "the third appeal.") By stipulation, the first, second and third appeals have been consolidated.

ISSUES

Prudential contends that the trial court's orders of March 1990 effected a denial of its initial petition to compel arbitration. Prudential further contends that the trial court erred in denying its second and third petitions to compel arbitration on grounds of waiver and awarding sanctions in conjunction with those rulings. Finally, Prudential contends that Rice's claims are subject to arbitration under Form U-4.[8]

---

[8] Based on our analysis and disposition of the contentions regarding waiver, we do not reach the issue of whether Rice's claims are subject to arbitration.

DISCUSSION[9]

I.

THE FIRST APPEAL

Prudential contends that the trial court's order of March 14, 1990, placing its petition to compel arbitration off calendar, and its order of March 15, 1990, denying its ex parte application for an order shortening time, effectively constituted a denial of the petition, thereby creating an appealable order under section 1294, subdivision (a). Prudential therefore urges that this court is required to determine the propriety of denying arbitration as of the dates of those orders. We find Prudential's contention to be without merit.

Section 104 of the Los Angeles Law & Discovery Policy Manual, which adopts rule 227 of the California Rules of Court, characterizes the failure to comply with local rules "an unlawful interference with the proceedings of the court," and authorizes the court, among other things, to "order an appropriate change in the calendar status of the action, in addition to any other sanction permitted by law."[10] The Los Angeles Law & Discovery

---

[9] Citing *Foreman & Clark Corp.* v. *Fallon* (1971) 3 Cal.3d 875, 881, for the well-established rule that the appellant carries the burden of setting forth all material evidence on a disputed point, Rice argues that Prudential's failure to set forth certain procedural facts which it deems relevant constitutes a waiver by Prudential in this court of any right to arbitrate. We decline to find such a waiver, and proceed with the analysis of the issues presented on appeal.

[10] See Los Angeles County Delay Reduction Program, Trial Court Delay Reduction Rules, rule 1303.2 (Law & Discovery Policy Manual remains in effect under delay reduction rules).

Policy Manual has the force of law. (See *Mann* v. *Cracchiolo* (1985) 38 Cal.3d 18, 29; *City of El Monte* v. *Takei* (1984) 158 Cal.App.3d 244, 247-248.)

Prudential correctly asserts that the key in determining appealability is not the form of the judgment or order, but its legal effect. (*Daar* v. *Yellow Cab Co.* (1967) 67 Cal.2d 695, 698-699; *Jones* v. *Los Angeles Community College Dist.* (1988) 198 Cal.App.3d 794, 799, fn. 1.) However, Prudential has failed to demonstrate how this rule applies to the instant facts or to provide any authority which would even remotely suggest that orders deferring consideration of a petition based on multiple violations of local rules be deemed a denial of the petition,[11] or that the violations are required to be disregarded under section 475[12] and are prohibited from adversely affecting a party under section 575.2, subdivision (b).[13]

In refusing to hear Prudential's petition to vacate on March 14, 1990, the trial court was acting within the bounds of its authority to effect the orderly administration of justice by assuring compliance with local rules.

---

[11] As Prudential itself recognizes, *Helzel* v. *Superior Court* (1981) 123 Cal.App.3d 652 is distinguishable because it did not involve an appeal. Moreover, the trial court in *Helzel* was laboring under the misassumption that the statutory arbitration scheme permitted deferral of a petition for arbitration under the circumstances presented. (*Id.* at pp. 660-661.)

[12] Section 475 requires the court to disregard any defect "which, in the opinion of said court, does not affect the substantial rights of the parties."

[13] Section 575.2, subdivision (b), provides that compliance with local rules is the responsibility of counsel, and should not "adversely affect the party's cause of action or defense thereto."

Prudential's violations, although of a technical nature, were ample cause for the court to take the hearing on the petition off calendar and leave it off pending adequate notice for the next regularly scheduled hearing date. Accordingly, there is nothing to distinguish the trial court's orders of March 14 and 15, 1990, from any other nonappealable interlocutory orders, and Prudential's purported appeal therefrom must be dismissed. (§ 904.1; 9 Witkin, Cal. Procedure (3d ed. 1985) Appeal, § 37, pp. 60-61.)

II.

THE SECOND APPEAL

Prudential contends that the trial court, when it denied the second petition upon the basis of waiver and when it granted sanctions to Rice, committed error. We find the denial proper, but hold that sanctions were not warranted.

A. Denial of the Petition for Arbitration

The parties agree that Form U-4 required arbitration of claims within the purview of the National Association of Securities Dealers' Code of Arbitration Procedure, which is governed by the Federal Arbitration Act (9 U.S.C. § 1 et seq.; hereafter, "the Act"). (*Hall* v. *Nomura Securities International* (1990) 219 Cal.App.3d 43, 49-50). "The Act is a 'congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary. The effect of [the Act] is to create a body of

federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act. . . . [The Act] establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration. . . . ' [Citation.] The Act is enforceable in state as well as federal courts [citation], and it preempts state laws precluding arbitration of claims." (*Id.* at p. 48.)

"The law in [the] area [of waiver] is rather well defined. Arbitration is strongly favored. Courts will closely scrutinize any claims of waiver [citations], and " 'indulge every intendment to give effect to such proceedings." [Citation.]' [Citation.] Moreover, the burden of proof is 'heavy' and rests on the party seeking to establish waiver [citations] which 'is not to be lightly inferred.' [Citations.]

". . . .

"[W]hile there is no 'single test' in establishing waiver, the relevant factors include whether the party seeking arbitration (1) has 'previously taken steps inconsistent with an intent to invoke arbitration,' (2) 'has unreasonably delayed' in seeking arbitration, (3) or has acted in 'bad faith' or with 'wilful misconduct.' [Citations.] [The Supreme Court has] stressed the significance of the presence or absence of prejudice. Waiver does not occur by mere participation in litigation; there must be 'judicial *litigation* of the merits of arbitrable issues' [citation], although 'waiver could occur prior to a judgment on the merits if prejudice could be demonstrated' [citation]. This result is fully consistent with federal cases which have held that 'as an abstract exercise in logic it

may appear that it is inconsistent for a party to participate in a lawsuit for breach of a contract, and later to ask the court to stay that litigation pending arbitration. Yet the law is clear that such participation, standing alone, does not constitute a waiver [citations], for there is an overriding federal policy favoring arbitration. . . . [M]ere delay in seeking a stay of the proceedings without some resultant prejudice to a party [citation], cannot carry the day.' [Citations.]" (*Keating* v. *Superior Court* (1982) 31 Cal.3d 584, 604-606, revd. on other grounds sub nom. *Southland Corp.* v. *Keating* (1984) 465 U.S. 1.)

"Prejudice is derived from the fact the opposing party must bear the costs of trial preparation, which arbitration is designed to avoid [citations], and also results from the disclosure of defenses and strategies [citation]." (*Zimmerman* v. *Drexel Burnham Lambert Inc.* (1988) 205 Cal.App.3d 153, 159-160.)

In addressing the question of waiver, the parties have relied on seemingly conflicting cases and apparent differences in state and federal law. However, as explained below, under the facts of this case such conflicts and differences are of no consequence.

Case law demonstrates that the courts have indeed been reluctant to deem arbitration to have been waived based on lack of an immediate demand therefor. Thus, as noted by Prudential, in *Keating* v. *Superior Court, supra,* 31 Cal.3d at pages 606-607, the defendant's filing of counterclaim and participation in discovery did not require a finding of waiver, and in *Outdoor Services, Inc.* v. *Pabagold, Inc.* (1986) 185 Cal.App.3d 676, 684-685, the trial court's finding of non-waiver was affirmed where the defendant

sought an attachment and filed a cross-complaint prior to demanding arbitration. Moreover, in *Fisher* v. *A. G. Becker Paribas Inc.* (9th Cir. 1986) 791 F.2d 691, 694-698, *Lake Communications, Inc.* v. *ICC Corp.* (9th Cir. 1984) 738 F.2d 1473, 1480-1482, and *Rush* v. *Oppenheimer & Co.* (2d Cir. 1985) 779 F.2d 885, 887-890, no waiver was found where arbitration demands were not made until after the parties had engaged in substantial discovery. (However, as noted by the court in *Zimmerman* v. *Drexel Burnham Lambert Inc., supra,* 205 Cal.App.3d at p. 160, *Fisher* involved both arbitrable and nonarbitrable claims, and is therefore "distinguishable, as the discovery which had been conducted there could be used in the trial of the nonarbitrable claims." The same distinction applies to *Lake Communications* and *Rush.*)

On the other hand, defendants' participation in extensive discovery has provided a valid basis for finding of waiver of arbitration in *Peterson* v. *Shearson/American Exp., Inc.* (10th Cir. 1988) 849 F.2d 464, 467-468, *Price* v. *Drexel Burnham Lambert, Inc.* (5th Cir. 1986) 791 F.2d 1156, 1158-1162, and *Fraser* v. *Merrill Lynch Pierce, Fenner & Smith, Inc.* (4th Cir. 1987) 817 F.2d 250, 251-252. (See *Zimmerman* v. *Drexel Burnham Lambert Inc., supra,* 205 Cal.App.3d at p. 159.)

Moreover, Prudential contends that the issue of waiver is governed by federal law. Relying on *Rice* v. *Dean Witter Reynolds, Inc.* (1991) 235 Cal.App.3d 1016, Rice asserts that such determination should be made in accordance with state law.

In *Rice* v. *Dean Witter,* the court noted that arbitration is heavily favored under the Federal Arbitration Act, but

observed, "[n]evertheless, despite the policy in favor of arbitration, the Act specifically states that an arbitration clause is enforceable *unless* there are 'grounds as exist at law or in equity for the revocation of *any* contract.' (9 U.S.C. § 2, italics added.) 'Thus state law, whether of legislative or judicial origin, is applicable [to arbitration clauses] *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally.' (*Perry* v. *Thomas* (1987) 482 U.S. 483, 493, fn. 9 [96 L.Ed.2d 426, 437, 107 S.Ct. 2520], italics in original; [citation].)" (235 Cal.App.3d at p. 1023.)

On appeal, Prudential focuses on the language of 9 Unites States Code section 2 and argues that only the issue of "[w]hat constitutes 'grounds for revocation' is determined by reference to applicable state law." However, in so doing, Prudential ignores the next sentence of *Rice*, in which the United States Supreme Court is quoted as holding that state law governs issues of validity and enforceability of contracts, as well as revocability.

In addition to whatever differences may exist between state and federal substantive law, a pronounced difference exists between state and federal standards of appellate review of waiver determinations. In the federal courts, the question of waiver is seen as one of law, therefore subject to de novo review. (*Britton* v. *Co-Op Banking Group*. (9th Cir. 1990) 916 F.2d 1405, 1409; *Fisher* v. *A. G. Becker Paribas Inc., supra*, 791 F.2d at p. 693; *Rush* v. *Oppenheimer & Co., supra*, 779 F.2d at p. 887.) In California courts, a trial court's determination regarding waiver of arbitration is considered one of fact, and is binding on an appellate court if supported by substantial evidence. (*Keating* v. *Superior Court, supra*, 31 Cal.3d at p. 605.)

In the context of this case, we need not decide whether the state or federal standard of waiver should be applied or whether the trial court's determination is subject to de novo review or the substantial evidence test. As to the former, we perceive no meaningful differences in the waiver analyses undertaken by state and federal courts, and as to the latter, we find no reason to reverse the order of the trial court under any standard of review.

Apart from questions of when Prudential first discovered the existence of Form U-4, and when and how it first demanded arbitration, the reality of this case is that a judicial determination of the validity of that demand (with its attendant issue of whether Form U-4 covered Rice's claims) did not take place until the very eve of trial, after the completion of a tremendous amount of discovery (which required judicial resolution of several contested issues) and a " 'judicial *litigation*' " (*Keating* v. *Superior Court, supra,* 31 Cal.3d at p. 605) in Rice's favor of Prudential's motion for summary adjudication of issues. By the time of the hearing Rice, through no fault of her own, had been required to "bear the cost of trial preparation, which arbitration is designed to avoid" (*Zimmerman* v. *Drexel Burnham Lambert Inc., supra,* 205 Cal.App.3d at p. 159), and had been forced to "disclos[e her] defenses and strategies." (*Id.* at pp. 159-160.) The trial court therefore acted well within its authority in rendering its finding of waiver and in refusing to determine the question of arbitrability on its merits.

B. Sanctions

Section 128.5 requires a finding of "bad-faith actions or tactics that are frivolous or solely intended to cause unnecessary delay." (Subd. (a).) This has been held to mean that the sanctioned party must necessarily be guilty of bad faith. (*Javor* v. *Dellinger* (1992) 2 Cal.App.4th 1258, 1259; *Summars* v. *City of Cathedral City* (1990) 225 Cal.App.3d 1047, 1070; *Llamas* v. *Diaz* (1990) 218 Cal.App.3d 1043, 1047-1048.) The award of sanctions or refusal to grant them is within the sound discretion of the trial court and will not be reversed on appeal absent a manifest showing of abuse. (*Olson Partnership* v. *Gaylord Plating Lab, Inc.* (1990) 226 Cal.App.3d 235, 240; *Salowitz Organization, Inc.* v. *Traditional Industries, Inc.* (1990) 219 Cal.App.3d 797, 806.)

In awarding sanctions upon denial of Prudential's second petition for arbitration, the trial court found "that by bringing this petition before the Court at this time, [Prudential has] engaged in a bad faith tactic that is frivolous in that it appears to have been made for the sole purpose of harassing [Rice]." Although the sanctions award was thus couched in the proper phraseology, we find that it constituted an abuse of discretion.

While we have held that the trial court acted properly in denying the second petition, the sole reason Prudential's petition was being heard "at this time" (i.e., May 4, 1990) was that its original petition to compel arbitration had been taken off calendar the previous March 14 for technical defects, and the court denied Prudential's March 15 request to return the petition to the calendar

with its defects cured. Moreover, Prudential has consistently taken the position that the question of its waiver of arbitration must be assessed as of January 1990, when Rice refused its demand for arbitration, and has cited cases in which the defendant was considered to be merely protecting its own interests in continuing to participate in litigation after a request for arbitration had been refused by the plaintiff. (See *Tenneco Resins, Inc.* v. *Davy Intern., A.G.* (5th Cir. 1985) 770 F.2d 416, 421; *Davis Corp.* v. *Interior Steel Equipment Co.* (D.D.C. 1987) 669 F.Supp. 32, 33-34; *Pacific Inv. Co.* v. *Townsend* (1976) 58 Cal.App.3d 1, 12.)

It is thus apparent that, while the trial court's finding of waiver was proper, such finding was not necessarily required under the circumstances of this case. Accordingly, the determination that Prudential's conduct in bringing the second petition was frivolous and in bad faith for the sole purpose of harassing Rice is without foundation and must be reversed. (Cf. *Optical Surplus, Inc.* v. *Superior Court* (1991) 228 Cal.App.3d 776, 785.)

III.

THE THIRD APPEAL

The third petition was directed to new claims included in Rice's third amended complaint and was denied solely on the basis that the finding of waiver as to the second petition operated for the "whole case."[14]

---

[14] In addition to the trial court's comment, quoted above, that "[o]nce your right to arbitrate is waived, it's waived for the whole case," the trial court further stated that "it is wrongful to

Prudential contends, and we agree, that the trial court's ruling was unsupported.

In *Keating* v. *Superior Court, supra,* 31 Cal.3d 584, plaintiffs sought to coordinate and amend their complaints, "considerably expand[ing] the scope of their pleadings, raising several new causes of action, injecting new factual elements, and refocusing the direction of their claims." (*Id.* at p. 607.) Noting that a previous waiver of arbitration would not extend to the newly raised issues in that case, the Supreme Court did "not suggest that an amendment to a complaint will, per se, nullify a previous, effective waiver of arbitration in every case." (*Ibid.*)

The third petition presented questions about the arbitrability of the claims newly raised in the third amended complaint. In order to properly determine whether those claims were subject to arbitration, it was necessary for the trial court to consider not only the underlying merits of whether Rice was subject to Form U-4 requirements and whether Form U-4 covered her new claims, but also the relationship between the old and the new claims with respect to the viability of the prior finding of waiver. Because the trial court failed to do so, resting its denial on the erroneous concept that the prior finding of waiver was res judicata, we find it appropriate to remand the matter for a redetermination of whether Prudential waived any right to arbitration on the new claims and, if

---

bring the same thing twice, once it's been adjudicated. I'm still of the opinion [the earlier finding of waiver is] res judicata."

no waiver is found, a determination of whether the claims are subject to arbitration under Form U-4.[15]

DISPOSITION

The purported appeal in B049037 is dismissed. In B050301, the order denying the petition to compel arbitration is affirmed and the order awarding sanctions is reversed. In B060473, the orders denying the petition to compel arbitration and awarding sanctions are reversed; the matter is remanded to reconsider these orders in accordance with the views expressed in this opinion. The parties are to bear their own costs on appeal.

NOT TO BE PUBLISHED.

DUNN, J.*

We concur:

SPENCER, P.J.

VOGEL, J.

---

[15] Based on this disposition, the sanctions awarded in conjunction with the order denying the third petition are also reversed.

* Assigned by the Chairperson of the Judicial Council.

SUPERIOR COURT OF CALIFORNIA,
COUNTY OF LOS ANGELES

04/90	)	DEPT. 36
DAVID A. WORKMAN	)	DEPUTY CLERK S. RAINWATER
JUDGE	)	
JUDGE PRO TEM	)	M. PETTIT
C. RHAMEO CRT.ATT./ Deputy Sheriff	)	Reporter (Parties and counsel checked if present)

C708681
MERLA RICE
vs
PRUDENTIAL LIFE INSURANCE OF AMERICA, et al

Counsel for Plaintiff
J. ELSON (x)
Counsel for Defendant
EPSTEIN BECKER MULKEEN & GREEN by:
J. MULKEEN (x)

NATURE OF PROCEEDINGS.

PETITION OF DEFENDANTS TO COMPEL ARBITRATION

The Court overrules the objection of responding party to the entirety of the declaration of Andrew Barnes proffered in support of the petition. The declarations and other evidence proffered in support of and opposition to the petition are received by reference to the file.

The petition is denied.

Taking judicial notice of the entirety of its own file, the Court finds that petitioners delayed unreasonably in seeking to invoke arbitration, doing so approximately 17

months after the complaint was filed and on the very eve of trial, long after the Court had set dates for discovery cut-off, trial setting conference and even trial, and particularly after judicial litigation of the merits of arbitratable issues upon the Court's determination of petitioners' motion for summary adjudication of issues. The Court holds that by such delay, petitioners have waived their right, if any, to compel arbitration under the subject arbitration agreement. Keeting v. Superior Court (1982) 31 Cal.3d 584, 605.

Responding party's request for sanctions is granted, as prayed. The Court finds that by bringing this petition before the Court at this time, petitioners have engaged in a bad faith tactic that is frivolous in that it appears to have been made for the sole purpose of harassing the plaintiff. As sanctions, they and their counsel, shall, within five days after entry of Judgment, pay plaintiff's counsel $3,000.00.

Notice is waived.

DEPT. 36

SUPERIOR COURT OF CALIFORNIA,
COUNTY OF LOS ANGELES

Date: July 30, 1991

Honorable	CAROL J. FIELDHOUSE	• Judge
		• Deputy Sheriff
#1	GRACIE PADILLA	• Court Attendant
	REGINA ALLEN	• Deputy Clerk
	CECIL KNICKERBOCKER	• Reporter
		• E/R Monitor

C 708 681 (Parties and Counsel checked if present)

MERLA RICE	Counsel for Plaintiff J. ELSON (X)
PRUDENTIAL LIFE INSURANCE OF AMERICA	Counsel for Defendant D. GOLDSTEIN (X)

NO LEGAL FILE

NATURE OF PROCEEDINGS: MOTION TO COMPEL ARBITRATION AND STAY COURT ACTION

THE DEFENDANT'S MOTION TO COMPEL ARBITRATION AND STAY COURT ACTION IS ARGUED AND DENIED.

THE MOVING PARTY TO GIVE NOTICE.

THE PLAINTIFF'S REQUEST FOR SANCTIONS IS ARGUED AND GRANTED. THE COURT IMPOSE SANCTIONS IN THE AMOUNT OF $2500.00 PAYABLE TO THE, JOHN ELSON, ATTORNEY AT LAW, A PROFESSIONAL CORPORATION AND AGAINST THE, EPSTEIN, BECKER, MULKEEN, AND GREEN WITHIN 30 DAYS.

A COPY OF THIS ORDER IS MAILED AS FOLLOWS:

DONNA FIELDS GOLDSTEIN, ESQ.
EPSTEIN, BECKER, MULKEEN, AND GREEN
1875 CENTURY PARK EAST, SUITE 1000
LOS ANGELES, CA. 90067-2501

DEPT. 36

Minutes Entered: July 30, 1991

Second Appellate District, Division One,
No. B049037
B050301/B060473
S031183

IN THE SUPREME COURT OF THE
STATE OF CALIFORNIA

IN BANK

MERLA RICE, Respondent

v.

PRUDENTIAL INSURANCE COMPANY OF AMERICA
Et Al., Appellants

(Filed Mar 31 1993)

Petitions for review DENIED.

LUCAS
Chief Justice

COURT OF APPEALS OF THE STATE OF CALIFORNIA
FOR THE SECOND APPELLATE DISTRICT
DIVISION: 1

Manatt Phelps Phillips & Kantor
11355 W. Olympic Blvd.

Los Angeles, CA. 90064

RE: Rice, Merla
vs.
Prudential Insurance Company of America
2 Civil B049037
Los Angeles NO. C708681

* * REMITTITUR NOTICE * *

Notice is hereby given that the Remittitur has been issued this date and that the opinion, decision or order entered in the above entitled cause on 01/05/93 is now final.

* * Dismissed By Opinion. * *

Each Party To Bear Their Own Costs.

JOSEPH A. LANE, Clerk

By: V. Salas
Deputy Clerk

JAMES P. MULKEEN
ROBERT A. DOLINKO
EPSTEIN BECKER MULKEEN & GREEN
1875 Century Park East, Suite 1000
Los Angeles, California 90067-2501
Telephone: (213) 556-8861

Attorneys for Defendants
The Prudential Insurance
Company of America, Lewis Eppolito
and Firoz Khan

SUPERIOR COURT OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF LOS ANGELES

MERLA RICE, Plaintiff, vs. PRUDENTIAL INSURANCE COMPANY OF AMERICA, a Delaware corporation; LEWIS EPPOLITO, an individual; FIROZ KHAN, an individual; and DOES 1 through 25, inclusive, Defendants.	CASE NO. C 708 681 DEFENDANTS' MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF VERIFIED PETITION TO COMPEL ARBITRATION AND TO STAY COURT ACTION HEARING RESERVED DATE: May 4, 1990 TIME: 9:00 a.m. DEPT.: 36 TRIAL DATE: May 7, 1990

(Filed April 19, 1990)

* * *

Numerous cases decided under the Federal Arbitration Act have stayed proceedings where it is far less clear than here that the dispute is arbitrable.

Page 8

* * *

Federal cases similarly hold that a party's delay in moving to compel arbitration is not a waiver. For example, in *Lake Communications, Inc. v. ICC Corporation,* (9th Cir. 1984) 738 F.2d 1473, the defendant did not seek arbitration until more than a year after the complaint had been filed. The defendant had taken some discovery and had deposed the president of the plaintiff corporation. On these facts, facts similar to those in this case, the court affirmed the trial court's order compelling arbitration.

Page 11

* * *

The agreements between defendant The Prudential and plaintiff Rice, which are embodied in the Forms U-4, are written agreements subject to the provisions of the Federal Arbitration Act, 9 U.S.C. section 2.

Page 13

* * *

---

2 CIVIL No. B 049037; B 050301; B 060473

IN THE
COURT OF APPEAL FOR THE
STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT DIVISION ONE

MERLA RICE,

Plaintiff and Respondent,

vs.

THE PRUDENTIAL INSURANCE COMPANY OF AMERICA, LEWIS EPPOLITO AND FIROZ KHAN,

Defendants and Appellants
Case No. B 049037 –
LASC No. C 708681

MERLA RICE,

Plaintiff and Respondent,

vs.

THE PRUDENTIAL INSURANCE COMPANY OF AMERICA, LEWIS EPPOLITO AND FIROZ KHAN,

Defendants and Appellants
Case No. B 050301 –
LASC No. C 708681

MERLA RICE,

Plaintiff and Respondent,

vs.

THE PRUDENTIAL INSURANCE COMPANY OF AMERICA, LEWIS EPPOLITO AND FIROZ KHAN,

Defendants and Appellants
Case No. B 060473 –
LASC No. C 708681

APPEAL FROM THE SUPERIOR COURT OF
LOS ANGELES COUNTY
HONORABLE DAVID A. WORKMAN,
HONORABLE CAROL J. FIELDHOUSE, JUDGES

APPELLANTS' OPENING BRIEF

(Filed March 13, 1992)

DONNA FIELDS GOLDSTEIN
MANATT, PHELPS, PHILLIPS & KANTOR
11355 West Olympic Boulevard
Los Angeles, CA 90064
(310) 312-4000
Attorneys for Defendants and Appellants
THE PRUDENTIAL INSURANCE COMPANY OF AMERICA, LEWIS EPPOLITO AND FIROZ KHAN

* * *

1. Federal Law Governs the Enforcement of the Arbitration Agreement

The United States Supreme Court has stated that in enacting section 2 of the Federal Arbitration Act (9 U.S.C. § 2), "Congress has thus mandated the enforcement of arbitration agreements." ***Southland Corp. v. Keating*** (1984) 465 U.S. 1, 10 [104 S.Ct. 852, 79 L.Ed.2d 1]. The Supreme Court continued finding:

> We discern only two limitations on the enforceability of arbitration provisions governed by the Federal Arbitration Act: they must be part of a written maritime contract or a contract "evidencing a transaction involving commerce" and such clauses may be revoked upon "grounds as

> exist at law or in equity for the revocation of any contract."

465 U.S. at pp. 10-11.

It is beyond reasonable dispute that the Form U-4 arbitration agreement is a contract "evidencing a transaction involving commerce" and falls within the definition of "commerce" for purposes of the Federal Arbitration act. In ***Snyder v. Smith*** (7th Cir. 1984) 736 F.2d 409, ***cert. den.***, 469 U.S. 1037 [105 S.Ct. 513, 83 L.Ed.2d 403], the Seventh Circuit stated:

> [B]ecause of the strong policy favoring arbitration, the requirement of "evidencing a transaction involving commerce" must be construed broadly. . . . [¶] Thus the [Supreme Court] equated the breadth of "involving commerce" with the extent of Congress's power to regulate under the commerce clause. Under the commerce clause, Congress may reach activities "affecting" interstate commerce. [See, e.g., ***Hodel v. Virginia Surface Mining & Reclamation Assn.*** (1981) 452 U.S. 264, 276-277 [101 S.Ct. 2352, 69 L.Ed.2d 1]] That the requirement that an arbitration agreement involve commerce is not a limitation but a qualification suggests that Congress intended the FAA to apply to all contracts that it constitutionally could regulate.

Pages 15-16

* * *

Likewise, the federal courts have also been reluctant to find waiver of the right to arbitration under the Federal Arbitration Act and have consistently held that a party's delay in moving to compel arbitration is not a

waiver. For example, in ***Lake Communications, Inc. v. ICC Corp.*** (9th Cir. 1984) 738 F.2d 1473, the defendant did not seek arbitration until more than a year after the complaint had been filed. The defendant had taken some discovery and had deposed the president of the plaintiff corporation. On these facts the court affirmed the trial court's order compelling arbitration. Accord ***ATSA of California, Inc. v. Continental Insurance Co.*** (9th Cir. 1983) 702 F.2d 172, 175 (delay in filing motion to compel arbitration and engaging in discovery does not waive a party's right to arbitration), ***amended by*** (9th Cir. 1985) 754 F.2d 1394.

Pages 18-19

* * *

ORIG. FILED
FEB. 17, 1993

2d Civil Nos. B-049037; B-050301; B-060473 (Consolidated)
(L.A.S.C. NO. C 708681)

In the
SUPREME COURT OF THE STATE OF CALIFORNIA

MERLA RICE,

Plaintiff and Respondent,

vs.

THE PRUDENTIAL INSURANCE COMPANY OF AMERICA, LEWIS EPPOLITO AND FIROZ KHAN,

Defendants and Appellants

MERLA RICE,

Plaintiff and Respondent,

vs.

THE PRUDENTIAL INSURANCE COMPANY OF AMERICA, LEWIS EPPOLITO AND FIROZ KHAN,

Defendants and Appellants

MERLA RICE,

Plaintiff and Respondent,

vs.

THE PRUDENTIAL INSURANCE COMPANY OF AMERICA, LEWIS EPPOLITO AND FIROZ KHAN,

Defendants and Appellants

Appeal from the Superior Court, Los Angeles County
HON. DAVID A. WORKMAN and
HON. CAROL J. FIELDHOUSE, JUDGES

PETITION FOR REVIEW

ROBERT E. HINERFELD
DONNA FIELDS GOLDSTEIN
MANATT, PHELPS & PHILLIPS
11355 West Olympic Boulevard
Los Angeles, CA 90064
(310) 312-4000; Fax: (310) 312-4224

Attorneys for Defendants/ Appellants/Petitioners
THE PRUDENTIAL INSURANCE COMPANY OF AMERICA, LEWIS EPPOLITO and FIROZ KHAN.

* * *

A. Review Should Be Granted to Clarify The Standards for Finding a Waiver of Arbitration under the FAA Where the Material Facts Are Not In Dispute.

The main mischief done in the opinion below was to obscure the fact that questions of waiver of a right to arbitration under the Federal Arbitration Act are questions of law which must be decided on appeal without any deference to the trial court's views when there are no material facts in dispute.

Pages 13-14

* * *

In fact, when, after a test under the controlling federal and California principles, there is no substantial evidence in the record to overcome the federal anti-waiver presumption, the reviewing court must rule as a matter of law that the trial court committed prejudicial error when it found that the defendant had waived its right to arbitrate.

Page 18

* * *

RULE 29.1 LIST

Fine Homes, L.P.

Industrial Trust Company

Prudential Mutual Fund Management, Inc.

Prudential of America Life Insurance Company (Canada)

Prudential Realty Securities II, Inc.

OTIPIRAEO Insurance Company, Inc.

Prudential of America General Insurance Company (Canada)

Centermark Properties Finance II, Inc.

Sunbelt Title Agency, Inc.

Prudential Asia Investments Limited

Prudential Asia DBS Limited

Simmons Co. Limited

Simmons Asia Limited

Prudential Mutual Fund Management, Inc.

Lapine Holding Company

Prudential Asia Investments Limited

Prudential-Bache Capital Partners

No. 93-13

In The

Supreme Court of the United States

October Term, 1993

THE PRUDENTIAL INSURANCE COMPANY OF AMERICA, LEWIS EPPOLITO AND FIROZ KHAN,

Petitioners,

v.

MERLA RICE,

Respondent.

Petition For A Writ Of Certiorari To The Court Of Appeal For The State Of California (Second Appellate District, Division One)

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

JOHN ELSON
1040 S. Longwood Avenue
Los Angeles, California 90019
(213) 937-0246

Counsel of Record for Respondent MERLA RICE

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

BEST AVAILABLE COPY

I

QUESTIONS PRESENTED FOR REVIEW

1. May a California state court employ an "abuse of discretion" standard of review when considering a trial court finding of waiver, made under state law, of an alleged federal right to compel arbitration of an employment dispute?

2. Is there substantial evidence in the record which would support the finding of waiver, made under state law, of the alleged right to compel arbitration of the within employment dispute?

TABLE OF CONTENTS

		Page
I	QUESTIONS PRESENTED FOR REVIEW	i
II	THIS CASE DOES NOT WARRANT DISCRETIONARY REVIEW	1
III	AMPLE EVIDENCE OF CONDUCT AMOUNTING TO WAIVER IS IN THE RECORD	4
A.	The trial court did not refuse to hear petitioner's petition to compel arbitration in January of 1990	4
B.	Petitioners' conduct before April 2, 1990 as waiver	6
	1. Discovery	8
	2. Petitioners' resort to law and motion	10
C.	Submission of the motion for summary judgment as waiver	12
D.	Conduct inconsistent with arbitration after the summary judgment hearing	13
IV	RESPONDENT NEVER AGREED TO ARBITRATE HER CLAIMS AGAINST PETITIONERS	14
A.	The applicable law	15
B.	The writings which comprise the alleged agreement to arbitrate	16
C.	The object of the agreement to arbitrate	17
D.	Divining the intentions of the parties	18
	1. The NASD exception for insurance companies removes this case from the scope of NASD arbitration	18
	2. The requirement that the arbitrators be drawn from the securities industry	19

TABLE OF CONTENTS – Continued

Page

3. The NASD arbitration clause contained in the form signed by petitioner has been held to apply only to disputes over commissions and securities industry "clearing controversies" 19

CONCLUSION 22

TABLE OF AUTHORITIES

Page

CASES

Federal

AT&T Technologies, Inc. v. Comm. Workers of America (1986) 475 U.S. 643, 106 S.Ct. 1415, 89 L. Ed. 2d 648 15

Atkinson v. Sinclair Refining Co. (1962) 370 U.S. 238, 82 S.Ct. 1318, 8 L. Ed. 2d 462 15

Cupp v. Naughten (1973) 414 U.S. 141, 94 S. Ct. 396, 400, 38 L. Ed. 2d 368 4

Fletcher v. Weir (1982) 455 U.S. 603, 102 S. Ct. 1309, 71 L. Ed. 2d 490 ..... 3, 4

Peterson v. Shearson/American Express, Inc. (10th Cir. 1988) 849 F.2d 464 8

Southland Corp. v. Keating (1984) 465 U.S. 1 10

California

Aerojet-General Corp. v. Superior Court (1989) 211 Cal.App.3d 216 13

Berman v. Dean Witter & Co., Inc. (1975) 44 Cal.App.3d 999, 119 Cal.Rptr. 130 19

Ericksen, Arbuthnot, McCarthy, Kearney & Walsh, Inc. v. 100 Oak Street (1983) 35 Cal.3d 312, 197 Cal.Rptr. 581 15

TABLE OF AUTHORITIES – Continued

Page

Harris v. Klure (1962) 205 Cal.App.2d 574, 23 Cal.Rptr. 313 16

Keating v. Superior Court (1982) 31 Cal.3d 584, 183 Cal.Rptr. 360 ..... 10, 11

Moncharsh v. Heily & Blase (1992) 3 Cal.4th 1, 10 Cal.Rptr.2d 183 15

Wool v. Scott (1956) 140 Cal.App.2d 835 7

Zimmerman v. Drexel Burnham Lambert, Inc. (1988) 205 Cal.App.3d 153, 252 Cal.Rptr.115 ..... 6, 14

Alabama

A.G. Edwards & Sons, Inc. v. Clark (1990) 558 So.2d 358 ..... 20, 21

Illinois

Transamerica Financial Resources, Inc. v. Rondini (1989) 545 N.E.2d 789, 189 Ill.App.3d 853 20

STATUTES

Federal

9 USC §§ 1-12 8

California

Civil Code § 1642 16

RULES

Rules of the Supreme Court, Rule 10.1 2

No. 93-13

In The

Supreme Court of the United States

October Term, 1993

THE PRUDENTIAL INSURANCE COMPANY OF AMERICA, LEWIS EPPOLITO AND FIROZ KHAN,

Petitioners,

v.

MERLA RICE,

Respondent.

Petition For A Writ Of Certiorari To The Court Of Appeal For The State Of California (Second Appellate District, Division One)

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

II

THIS CASE DOES NOT WARRANT DISCRETIONARY REVIEW

This case is not a one which warrants review given the Supreme Court's considerations of when certiorari may be granted. Rule 10 of this Court's rules provides in pertinent part that

> A review on writ of certiorari is not a matter of right, but of judicial discretion. A petition for writ of certiorari will be granted only when

there are special and important reasons therefor, such as:

(a) When a United States court of appeal has rendered a decision in conflict with the decision of another United States court of appeals on the same matter; or has decided a federal question in a way in conflict with a state court of last resort; or has so far departed from the accepted and usual course of judicial proceedings, or sanctioned such a departure by a lower court, as to call for an exercise of this Court's power of supervision.

(b) When a state court of last resort has decided a federal question in a way that conflicts with the decision of another state court of last resort or of a United States court of appeals.

(c) When a state court or United States court of appeals has decided an important question of federal law which has not been, but should be, settled by this Court, or has decided a federal question in a way that conflicts with applicable decisions of this Court.

Rules of the Supreme Court, Rule 10.1.

In this case a trial court made a finding of waiver of any alleged contractual right[1] petitioners were supposed

---

[1] Petitioners based their right to compel arbitration on an NASD Form U-4 (Clerk's Transcript ["CT"] 704-708) which respondent signed when registering with the NASD as a representative of Pruco Securities Corp. several years after going to work for petitioner Prudential Life Insurance Co. of America. The trial court had expressed considerable skepticism on March 15, 1990, as to whether the arbitration clause in that form even applied to the claims being made by respondent, and indicated

to have had to compel respondent to arbitrate her employment related claims, rather than have them decided by a jury (petitioners' appendix at 21-22). In an unpublished decision the California court of appeal affirmed the trial court''s finding of waiver (*id.* at 11-18). In so doing the court of appeal stated that under either an "abuse of discretion" or the "de novo" standard of review the trial court was authorized to have found a waiver of the alleged right to compel arbitration (*id.* at 16).

There is no federal question requiring resolution by the Court arising from the state court's choice, or application, of the standard of review to be applied to the trial court's finding of waiver. This is the case because matters of appellate procedure may be defined and employed by state courts deciding federal questions, and a state court doing so does not decide a "federal question" merely by its choice of a standard of review even if a federal statutory right is being substantively considered.

In *Fletcher v. Weir,* 455 U.S. 603, 102 S. Ct. 1309, 71 L. Ed. 2d 490 (1982) the Court stated

> The principles which evolved on the basis of decisional law dealing with appeals within the federal court system are not, of course, necessarily based on any constitutional principle. Where they are not, the states are free to follow

---

that in the court's view respondent's claims were outside the ambit of the arbitration agreement upon which petitioners have chosen to rely (Reporter's Transcript ["RT"] I at 86-87). The scope and effect of the arbitration clause in question is addressed in section IV, infra.

> or to disregard them so long as the state procedure as a whole remains consistent with due process of law.

455 U.S. at 605, 102 S. Ct. at 1309, 71 L. Ed. 2d at ___, citing *Cupp v. Naughten*, 414 U.S. 141, 146, 94 S. Ct. 396, 400, 38 L. Ed. 2d 368 (1973).

Despite the holding by the court of appeal in this case that under either standard of review the trial court could correctly have made a finding of waiver, petitioners argue that a "de novo" standard of review is **required** because some of the federal circuits employ such a standard when reviewing issues of waiver (petition at 19-20), and that under the de novo standard the facts of this case preclude a finding of waiver (*id.* at 21-24).

This Court has by its teaching in *Ware*, supra, already rejected the former argument advanced by petitioners, and the facts of this case belie the latter.

III

AMPLE EVIDENCE OF CONDUCT AMOUNTING TO WAIVER IS IN THE RECORD

A. The trial court did not refuse to hear petitioner's petition to compel arbitration in January of 1990.

In their petition before this court petitioners assert that "[i]n early January [of 1990] the trial court would not hear [their] motion to compel arbitration on statutory notice, thereby delaying the first hearing until mid-March" (petition at 5). That assertion is false.

As the California court of appeal stated, when suit was filed it was assigned to one judge for all purposes pursuant to California's Trial Court Delay Reduction Act (petitioners' appendix at 2). When petitioners' then attorney called in "mid-January of 1990" to reserve a law and motion hearing date on the petition, she claimed she was told there were no open slots on the court's law and motion calendar until March (CT 1418-1419).

There was *absolutely no effort made by petitioners* to make an ex parte application *requesting an earlier hearing date*, at they should have done, and in fact as they did on January 12, 1990, the day after respondent refused arbitration, when petitioners filed an ex parte application to shorten time for service of a motion seeking to compel discovery from respondent (petitioners' appendix at 6, footnote 4).

This blasé approach to seeking to compel arbitration at the earliest possible moment nonplussed the California trial court and court of appeal, and explains why petitioners were deemed to have waived whatever alleged right they claimed to force respondent to arbitrate her claims.

Furthermore, while fully aware that the court's intervention to compel arbitration would be necessary, petitioners themselves made the most of every opportunity in February and early March to drag respondent before the trial court for law and motion matters before the petition to compel arbitration was scheduled to be heard in mid-March.

B. Petitioners' conduct before April 2, 1990[2] as waiver.

Petitioners have omitted significant portions of the procedural history in their presentation of the facts of the case, and these events explain why waiver was quite properly found by the trial court and affirmed by the court of appeal. As the court in *Zimmerman v. Drexel Burnham Lambert, Inc.* (1988), 205 Cal.App.3d 153, 252 Cal.Rptr. 115, observed

> Prejudice is derived from the fact that the opposing party must bear the costs of trial preparation, which arbitration is designed to avoid [citations] and also results from the disclosure of defenses and strategies [citations].

Id. at 159-160, 252 Cal.Rptr. at 118.

Here respondent contended in the trial and appellate courts that by March 14th, when petitioners' first petition to compel arbitration was ordered off calendar due to the slovenly manner in which the matter had been presented[3], and inarguably by May 4th, literally on the eve of trial when the second petition was heard, sufficient conduct inconsistent with the intent to invoke arbitration had occurred.

---

[2] This was the date on which defendants had a hearing on their motion for summary judgment, which the court denied in its entirety (CT I at 1839).

[3] As the appellate court noted, the trial court commented that petitioners' first petition to compel arbitration, ordered off-calendar on March 14, 1990, for its numerous defects, was "one of the sloppiest jobs [it had] seen in a long time" (petitioners' appendix at 4).

Respondent further contended this course of conduct by the petitioners had caused substantial prejudice to respondent in the form of costs and expenses, including attorney's fees, as well as revealing respondent's litigation strategy.

By the time petitioners had a hearing on their motion for summary judgment they had had the benefit of massive discovery, which had been very expensive for respondent. Though petitioners claim to have first become aware[4] in December of 1989 of their alleged right to seek arbitration (petition at 8), in January they sought to depose plaintiff despite the fact that the NASD code upon which they base their right to compel arbitration (CT I 1270-1291) does not allow for oral depositions as a matter of right but only for document exchanges on a modest scale (CT I at 1284).

---

[4] This is not a tenable proposition in California. As a matter of law petitioner Prudential **always had constructive knowledge** of its alleged right to arbitrate. It is well settled in California that the "[m]eans of obtaining knowledge is equivalent to knowledge in the absence of circumstances preventing investigation", *Wool v. Scott* (1956) 140 Cal.App.2d 835, at 844. In this case there were certainly no circumstances caused by respondent which prevented petitioner Prudential from investigating and discovering its alleged right to compel arbitration, and Prudential certainly had the means to obtain knowledge of its arbitration agreement since petitioners' counsel stated in a declaration that he discovered the arbitration agreement in December of 1989 in the local Prudential office where respondent had been employed (CT 1424-1425).

1. Discovery.

The Federal Arbitration Act, 9 USC §§ 1-12, is virtually silent on what discovery, if any, is allowed in arbitration proceedings. It is generally accepted that if a party seeking to compel arbitration has initiated discovery, that party has waived the right to compel arbitration since discovery is generally viewed as conduct inconsistent with the right to invoke arbitration.

For example, in *Peterson v. Shearson/American Express, Inc.* (10th Cir. 1988) 849 F.2d 464 the party seeking arbitration had deposed witnesses, as have petitioners here. The court held that by deposing witnesses, a procedure unavailable at arbitration, defendants had waived their right to compel arbitration.

Here, petitioners' unbridled resort to discovery unavailable to them in arbitration was drawn to the court's attention when respondent opposed the first petition to compel arbitration (CT I at 1220-1328). As of the close of business on Tuesday, March 6th, when respondent filed her opposition to the first petition to compel, petitioners had noticed the following depositions:

DEPONENT	DATE	TIME
Robert Kalmansohn, M.D.	3/8/90	9:30 a.m.
Juan Drachenberg, M.D.	3/8/90	2:30 p.m.
Bernard Kirzner, M.D.	3/9/90	9:30 a.m.
Lyle Rapp, M.F.C.S.	3/9/90	1:30 p.m.
George Jay	3/10/90	9:30 a.m.
Cathy Goodman, Ph.D.	3/12/90	9:30 a.m.
A.S. Montesi, Ph.D.	3/12/90	1:30 p.m.
Susan Nathe	3/13/90	3:00 p.m.
Joseph Gambone, M.D.	3/14/90	9:30 a.m.

DEPONENT	DATE	TIME
Samuel Pang, M.D.	3/14/90	1:30 p.m.
Gordon Griggs, M.D.	3/15/90	9:30 a.m.
M. Joel Scheinbaum, M.D.	3/15/90	1:30 p.m.
M. Joel Scheinbaum, M.D.	3/16/90	9:30 a.m.
Andrew Sawchuk	3/21/90	9:30 a.m.
James Rodriguez	3/21/90	2:00 p.m.
Sima Jonoobi	3/22/90	9:30 a.m.
Robert Shelton	3/23/90	9:30 a.m.
Susan Martz	3/23/90	3:00 p.m.
Robert Yanez	3/29/90	9:30 a.m.

(CT I at 1226-1227.)

Furthermore, petitioners had as of March 7, 1990, a week before their petition was to be heard on March 14th, deposed respondent for ten full working days (CT I at 1226; CT II[5] 83-92), as well as respondent's husband and one of her co-workers at Prudential, John Raimo (CT I at 1226), with a total cost to petitioner of $ 25,500.00 for attorney's fees (CT I at 1227). Respondent had also incurred attorney's fees in the amount of $ 2,500.00 in responding to numerous sets of petitioners' interrogatories, which would not have been available to them in arbitration (*id.*).

Accordingly, under the approach taken by federal courts upon whose decisions petitioners rely, by engaging in discovery unavailable to them in arbitration, such as

---

[5] CT I and RT I refer to the clerk's and reporters' transcripts prepared prior to January of 1991 when another all purpose judge was assigned to the case in the Los Angeles Superior Court, and CT II and RT II refer to the clerk's and reporters' transcripts prepared after January 1, 1991.

deposing witnesses and propounding interrogatories, petitioners waived the right to compel arbitration.

2. Petitioners' resort to law and motion.

Prior to having their first petition to compel arbitration heard petitioners were regularly before the trial court as the moving parties in various law and motion matters. As of February 15, 1990, petitioners had filed motions (a) to compel respondent's deposition to go forward, (b) to compel the production of documents, (c) to discover respondent's sexual conduct, and (d) to compel a psychiatric examination of respondent (CT I at 236-280, 724-838, 842-875).

As the California Supreme Court observed in *Keating v. Superior Court* (1982) 31 Cal.3d 584, 183 Cal.Rptr. 360, rev. on other grounds sub. nom. *Southland Corp. v. Keating* (1984) 465 U.S. 1,

> We have recently acknowledged that while there is no "single test" in establishing waiver, the relevant factors include whether the party seeking arbitration (1) has "previously taken steps inconsistent with an intent to invoke arbitration", (2) "has unreasonably delayed" in seeking arbitration, (3) or has acted in "bad faith" or with "willful misconduct". [Citation] We have stressed the significance of the presence or absence of prejudice. Waiver does not occur by mere participation in litigation, there must be "judicial litigation of the merits of arbitrable issues" [citation], although "waiver could occur

> prior to a judgment on the merits if prejudice could be demonstrated" [citation].

Id. at 605, 183 Cal.Rptr. at 372.

As review of petitioners' conduct reveals, they did their level best to litigate this case to death on a piecemeal basis. Accordingly, the trial court was fully justified in finding that petitioners waived any alleged right to compel arbitration by resort to the judicial machinery in such a way that is entirely inconsistent with an "intent to invoke arbitration".

Petitioners filed their first petition to compel arbitration on February 2nd, setting it for hearing for March 14. However, they filed motions on February 14th (CT I at 724-838, 842-875) to obtain and/or compel discovery which was not available to them under the NASD code, with those motions to be heard on March 1st, before petitioners had their petition heard on March 14th.

Petitioners have *never* offered an explanation as to why they did not seek to have the trial court hear their request to compel arbitration on March 1st, when their three discovery motions were to be heard, after they knew in early January that respondent would not agree to arbitrate her claims. Petitioners obviously timed their law and motion matters to obtain maximum use of the judicial machinery *before* the hearing on their request to have respondent ordered to arbitrate her claims. The timing of these law and motion matters was conduct sufficiently reeking of "bad faith" under *Keating* to justify a finding of waiver without more.

When their petition to compel arbitration was heard on its merits on May 4, 1990, the trial court pointed out to

petitioners' counsel that on March 15, 1990, the court had raised with counsel "the question as to whether this motion was timely in view of all that had taken place" (RT I at 86-87). At that time, petitioners had not even had their Motion for Summary Adjudication heard.

Doubtless the trial court had in mind the extensive discovery (ten days of plaintiff's deposition) and numerous law and motion proceedings in which petitioners had engaged prior to mid March when the first petition to compel arbitration was ordered off-calendar.

C. Submission of the motion for summary judgment as waiver.

Petitioners are curiously silent on the subject of having had a hearing in the trial court on April 2, 1990, on their motion for summary judgment. Their silence is telling in light of the position they took in the court of appeal in March of 1990 following the trial court's ordering the petition set for hearing on March 14th off calendar.

After that petition was ordered off calendar, petitioners again freely sought through law and motion orders that were not available in arbitration. The most significant of which was proceeding to have a hearing and submission of the motion for summary judgment on April 2nd.

Petitioners sought extraordinary relief in late March from the appellate panel of the court of appeal which ultimately heard the appeal. In their petition for extraordinary relief petitioners argued that "the hearing on

petitioners' Motion for Summary Adjudication of Issues, which will constitute submission on the merits and may, therefore, waive arbitration and moot this appeal, is scheduled for April 2, 1990 . . . " (CT 2662-2663).

Under California law, petitioners "having made the contention, may not now deny it to suit their present needs. One may not alter one's appellate argument as the chameleon does his color, to suit whatever terrain one inhabits at the moment", *Aerojet-General Corp. v. Superior Court* (1989) 211 Cal.App.3d 216, upon denial of rehearing at page 240, 258 Cal.Rptr. at 684, 686.

D. Conduct inconsistent with arbitration after the summary judgment hearing.

On April 19th petitioners made ex parte applications to be allowed to complete expert witness discovery past the cut-off date (CT I at 2155-2172, 2279-2280), and to compel respondent to make additional appearances for a psychiatric examination (CT I at 2174-2181, 2193-2229). The court denied the former and granted the latter (CT I at 2281) which required respondent to return for several more hours of testing and interviewing at the office of the psychiatrist hired by petitioners to testify against respondent.

On April 19th petitioners filed their second petition to compel arbitration, setting it for hearing on Friday, May 4th, the last court day prior to the trial date of May 7th (CT I at 2285-2374).

Additionally, by the time of the second petition to compel arbitration petitioners had required respondent to

reveal her strategy in these numerous law and motion proceedings, not the least of which was opposing petitioners' Motion for Summary Judgment, which the court denied on April 2, 1990 (CT I at 1839).

Under each of the possible bases of prejudice articulated by the court in *Zimmerman*, the trial court on May 4th quite properly held that petitioners were deemed to have waived the right to compel arbitration of any of respondent's claims in this case. Under any standard of review the California court of appeal quite properly upheld the trial court's finding of waived by petitioners.

IV

RESPONDENT NEVER AGREED TO ARBITRATE HER CLAIMS AGAINST PETITIONERS

Petitioners argue that upon the grant of certiorari the Court should remand with instructions to enter on order compelling respondent to arbitrate her claims (petition at 24-27). Such an order by the Court would be premature in that the California courts have not yet passed upon the scope of the arbitration clause in question, which is a matter of contract interpretation for the state courts, not this Court. Indeed, the court of appeal remanded for the trial court to do exactly that with regard to the claims added by respondent's third amended complaint (petitioners' appendix at 18-20).

Respondent nonetheless will briefly address the issue of arbitrability out of an abundance of caution.

A. The applicable law.

It has been cited as the "first principle of arbitration" (*AT&T Technologies, Inc. v. Comm. Workers of America* (1986) 475 U.S. 643, 648, 106 S.Ct. 1415, 1418, 89 L. Ed. 2d 648) that only those disputes which are the subject of the arbitration clause are those which must be submitted to arbitration. This Court held as much over a generation ago when it stated that

> Arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.

Atkinson v. Sinclair Refining Co. (1962) 370 U.S. 238, 241, 82 S.Ct. 1318, 1320, 8 L. Ed. 2d 462.

That is as much a part of California jurisprudence as it is in the federal system. As the California Supreme Court observed, "[t]he scope of arbitration is, of course, a matter of agreement between the parties . . . ", *Ericksen, Arbuthnot, McCarthy, Kearney & Walsh, Inc. v. 100 Oak Street* (1983) 35 Cal.3d 312, 323, 197 Cal.Rptr. 581, 587. The California Supreme Court in passing recently reaffirmed the validity of the notion that the arbitrator has no power to " . . . stray[] beyond the scope of the parties' agreement by resolving issues the parties did not agree to arbitrate", *Moncharsh v. Heily & Blase* (1992) 3 Cal.4th 1, 28, 10 Cal.Rptr.2d 183, 200.

The critical inquiry in determining if a dispute is subject to arbitration is the contract itself, or if no single document contains the complete contract, those writings which together comprise the agreement to arbitrate. Examination of them in this case reveals why the clause

relied upon by petitioners has no application to respondent's claims.

B. The writings which comprise the alleged agreement to arbitrate.

The form U-4 (CT 704-708) does not contain any definition as to the scope or arbitrable matters, the identities or particular specialties of those selected to be arbitrators, or discovery which would be permissible in an arbitration taking place pursuant to the NASD rules. **All of these terms are found in the "CODE OF ARBITRATION PROCEDURE" (CT 1270-1290) issued by the NASD.**

For that reason California *Civil Code* § 1642 ("Several contracts relating to the same matters, between the same parties, and made as parts of substantially one transaction, are to be taken together") applies. Reference to other writings reflecting the agreement's terms is therefore mandated under California law. As one frequently cited case put it,

> In construing the contract the court should strive to ascertain its object as reflected in the provisions thereof [citations]; **should be guided by the intention of the parties as disclosed by those provisions** [citations]; **should endeavor to effect the intention and object thus ascertained . . .**

Harris v. Klure (1962) 205 Cal.App.2d 574, at ___, 23 Cal.Rptr. 313 at 315.

Guided by these teachings the court must look at the facts of the case to determine the object of the contract and intentions of the parties.

C. The object of the agreement to arbitrate.

In determining the object of any contract, reference to the parties and their relationship to each other is one of the first steps in interpretation of the contract. Here, the purportedly contracting parties are respondent Merla Rice and Pruco Securities Corporation, a wholly owned subsidiary of petitioner Prudential. The purported agreement to arbitrate only relates to any claims she may have against Pruco arising out of plaintiff's offering of any Pruco products or services. **Pruco is neither a party to this lawsuit, nor do any allegations of the facts constituting the multiple causes of action pleaded in any way implicate the services offered by Pruco.** In the matter at bench respondent was employed by petitioner Prudential, and her supervisors were petitioners Kahn and Eppolito.

The NASD "Code of Arbitration Procedure" (CT 1270-1291) refers to securities industry and clearing controversies. It is a stretch beyond the limits of logic to interpret these terms to apply to an insurance salesperson, such as respondent, suing her superiors at the insurance company for sexual harassment.

The object of the contract to arbitrate securities industry and clearing controversies has no application to the claims which are the subject of respondent's suit against petitioners.

D. Divining the intentions of the parties.

1. The NASD exception for insurance companies removes this case from the scope of NASD arbitration.

Looking at the documents (the U-4 form and the "CODE OF ARBITRATION PROCEDURE") which comprise the alleged agreement to arbitrate, one sees very quickly that the intention of the parties, from an objective standpoint, was to insure that disputes regarding securities offered and/or sold by respondent on behalf of Pruco Sales Corp. were resolved through arbitration, rather than before a court.

The NASD document entitled "CODE OF ARBITRATION PROCEDURE" states that with regard to "matters eligible for submission", that

> This code of arbitration procedure is prescribed and adopted . . . for the arbitration of any dispute, claim, or controversy arising out of or in connection with the business of any member of the association [National Association of Securities Dealers], **with the exception of disputes involving the insurance business of any member which is also an insurance company . . .** [Emphasis added]

(CT I at 1273). In its introduction defining the scope of arbitral matters, the NASD Code excludes, with its use of the broadest possible language, any disputes involving the insurance business of any member of the NASD which is also an insurance company. It is difficult to read this language and still conclude that respondent's dispute

with her employer, an insurance company, would nonetheless be subject to arbitration under the NASD code.

2. The requirement that the arbitrators be drawn from the securities industry.

With regard to the composition of the panel of arbitrators, § 9 of the code specifies that those persons to sit as arbitrators "shall be from the securities industry" (CT I at 1275). A court construing these documents as an agreement to arbitrate must "look to the contract itself and interpret it so as to give effect to the intent of the contracting parties" (*Berman v. Dean Witter & Co., Inc.* (1975) 44 Cal.App.3d 999, at 1004, 119 Cal.Rptr. 130 at 133).

Given that the arbitrators in NASD arbitrations "shall be from the securities industry", it is clear that the arbitration agreement was meant to apply to individuals employed in the securities industry involved in transactions in securities. The scope of arbitral matters was not designed to include those persons, like respondent, who were employees of insurance companies, such as petitioner Prudential, who routinely had their sales agents register with the NASD merely so that those sales agents could, from time to time, provide financial services such as the sale of an annuity which arguably might be considered a "security".

3. The NASD arbitration clause contained in the form signed by petitioner has been held to apply only to disputes over commissions and securities industry "clearing controversies".

In a pair of sister-state opinions courts have considered the identical NASD Form U-4 and held that it does

not enjoy the sweep that petitioners advocated in this case.

In *Transamerica Financial Resources, Inc. v. Rondini* (1989) 545 N.E.2d 789, 189 Ill.App.3d 853, the employer, a securities brokerage firm, had sued a former employee to collect on a loan made to the employee. The employee had argued that the matter should be arbitrated because he had signed a NASD U-4 agreement mandating arbitration of all disputes arising out of the employer's securities business. The employer resisted arbitration on the ground that the suit involved a simple collection matter, not the trading business of the brokerage house which was within the purview of the NASD arbitration agreement.

The court held that the proper focus of the analysis was whether the claim in issue arose out of the transacting of the securities business, which would make it arbitrable, or whether it was merely an employment matter unrelated to the business of the brokerage house. After reviewing the facts and the law on the subject, the court held that

> . . . [the employer's] claim against defendant constitutes a simple collection matter arising out of the parties' employment relationship and has **no connection with its business as a retail broker of securities.**

Transamerica at 545 N.E.2d at 791. The case was followed by the Alabama Supreme Court's decision in *A.G. Edwards & Sons, Inc. v. Clark* (1990) 558 So.2d 358, which also construed the identical NASD arbitration agreement in issue in the matter at bench.

In *Edwards* an employee of a brokerage house sued a competitor in another brokerage house and that brokerage house for defamation. Defendants sought to compel arbitration based upon the NASD Form U-4 which the plaintiff had signed. The trial court denied the petition and the defendants appealed.

In affirming the trial court the Alabama Supreme Court pointed out that

> Section 8 of the NASD Code is included in Part II of that Code, labeled "INDUSTRY AND CLEARING CONTROVERSIES." Section 8 is intended to apply only to disputes related to the securities business. The fact that [defendant] Thompson was employed by a securities firm does not mean that every tort he commits creates an arbitrable "Industry" or "Clearing" controversy. . . .
>
> The NASD Code does not mandate arbitration for "*any* claim against a member," as the defendants would have us interpret it; it mandates arbitration of any claim "arising in connection with the business" of a member or "in connection with the activities" of an associated person. . . .
>
> By its very nature, the "business" of the members of the NASD is the trading of securities, and while arbitration clauses are to be interpreted broadly, they are not limitless and cannot be interpreted to include matters that clearly fall outside the scope of the contract agreement.

558 So.2d at 362, 363.



CONCLUSION

This case has no business taking the time of this Court. The California courts quite properly found waiver of any alleged right to arbitrate, and no federal question is presented by that finding.

Accordingly, the petition for certiorari should be DENIED.

DATED: August 26, 1993

JOHN ELSON
1040 S. Longwood Avenue
Los Angeles, California 90019
(213) 937-0246

Counsel of Record for
Respondent MERLA RICE